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## Investment-Environment Disputes: Challenges and Proposals

Mohamed F. Sweify\*

### INTRODUCTION

How effective is arbitration in resolving investment disputes, and what are the prospects of this method when the dispute involves non-investment issues, such as the environmental issues? These questions are likely to prompt diverse discussions and analysis of overlapping bodies of law. It is apparent that the system of investment arbitration is a dynamic system that evolves over time to present distinct challenges to its players, including arbitrators, foreign investors, host states, and third-party stakeholders.

Given the particular advantages globalization offers to international trade across borders, there are influxes of international trade and investment, which spur the economic development of developing countries. This globalization prompts states to transfer their sovereign power in decision-making from the national into the international level. Consequently, a massive number of international treaties in different fields have been concluded between states.<sup>1</sup> Foreign Direct Investment (“FDI”) constitutes a major stake in these treaties. The importance of FDI lies not only in the long-term source of development that involves international capital flows, but also in the features it brings to the developing countries, such as technologies, know-how, and profit, without contributing to the country’s debt burden.

Yet, the attractiveness of the developing countries to the rapid flow of international investment reflects lower environmental conditions in those countries.<sup>2</sup> Recently, the relationship between human activities and harmful impact upon the environment became indisputable.<sup>3</sup> Such relationship necessitates governmental interference to limit the

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1. Until 2008, there were around 2,500 treaties that have been entered into worldwide. See Barnali Choudhury, *Recapturing Public Power: Is Investment Arbitration’s Engagement of the Public Interest Contributing to the Democratic Deficit?*, 41 VAND. J. TRANSNAT’L L. 775 (2008).

2. DAVID HUNTER, JAMES SALZMAN & DURWOOD ZAELEKE, INTERNATIONAL ENVIRONMENTAL LAW AND POLICY at 1346 (2007).

3. See *infra* Part IV.

environmentally harmful activities. Consequently, International Investment Agreements (“IIAs”) began to address environmental concerns due to their importance.<sup>4</sup> Such interaction between investment laws and the heightened environmental standards reflects the potential impacts of the governmental measures enacted for environmental protection upon the investment activities.<sup>5</sup>

Although the environmental measures may threaten the profitability of the investment activities,<sup>6</sup> investors cast little consideration to the environmental issues. Usually, investors worry about the potential liability arising from past, present, and future environmental practices and the uncertainty over future environmental standards. Such uncertainties may adversely deprive the investors of the utility of the investment. On the other hand, states may view foreign investments as a restriction of their internal regulatory policy and powers to exercise national sovereignty<sup>7</sup> and may also be concerned about overwhelming foreign investors with burdensome regulations.<sup>8</sup>

On another note, foreign investments are not only challenges,<sup>9</sup> they are opportunities for environmental protection and sustainable development as well.<sup>10</sup> Foreign investment might bring with it *cutting-edge* environmental technologies that may help developing countries override the most damaging phases of their development.<sup>11</sup> However, states have legitimate fears regarding unsafe technologies that may affect the environment and human health in general.<sup>12</sup> Foreign invest-

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4. United Nations Conference on Trade and Development (UNCTAD), ENVIRONMENT, U.N. Doc. UNCTAD/ITE/IIT/23, UN Sales No. E.01.II.D.3 (2001), at 2 (2001), <http://unctad.org/en/docs/psiteiitd23.en.pdf>; Kathryn Gordon and Joachim Pohl, *Environmental Concerns in International Investment Agreements: A Survey*, Organisation for Economic Co-operation and Development (OECD), Working papers on International Investment 2011/01 (2011), [http://www.oecd.org/daf/inv/investment-policy/WP-2011\\_1.pdf](http://www.oecd.org/daf/inv/investment-policy/WP-2011_1.pdf).

5. Vivian H.W. Wang, *(Investor Protection or Environmental Protection? “Green” Development Under CAFTA)*, 32 COLUM. J. ENVTL. L. 251, 281 (2007).

6. Environmental concerns, in some authors’ opinions, are considered one of the sources of tension that may threaten international peace and security. Cesare P.R. Romano, *International Dispute Settlement in THE OXFORD HANDBOOK OF INTERNATIONAL ENVIRONMENTAL LAW* 1037 (Daniel Bodansky et al. eds., 2007).

7. Stephanie Bijlmakers, *Effects of Foreign Direct Investment Arbitration on a State’s Regulatory Autonomy Involving the Public Interest*, 23 AM. REV. INT’L ARB. 245 (2012).

8. Mary E. Footer, *BITS and Pieces: Social and Environmental Protection in the Regulation of Foreign Investment*, MICH. ST. J. INT’L L. 40 (2009).

9. Nadia B. Ahmad, *A National Mineral Policy As an International Investment Law Stratagem: The Case of Tajikistan’s Gold Reserves*, 27 PAC. MCGEORGE GLOBAL BUS. & DEV. L.J. 1, 5-6 (2014).

10. HUNTER ET AL., *supra* note 2, at 1344.

11. *Id.* at 1345.

12. An example of environmental disaster that resulted from dangerous and inappropriate technologies is the 1984 isocyanate gas leak in Bhopal, India, that killed several thousand people. This was caused by foreign investment bringing in environmentally hazardous technologies with

ments and strict environmental regulations together are an indispensable vehicle for Environmentally Sound Technology (“EST”) transfer which is paramount for the goal of sustainable development. Moreover, what is at stake is not the trade-off of “high investment-low environment,” but “continued investment-regulatory change.”<sup>13</sup>

There is a need to stabilize the investment framework conditions, procedurally and substantively,<sup>14</sup> and upgrade the standards of environmental protection. Furthermore, foreign investment correlates with the principles of human rights, which refers to environmental protection as one of its main goals. The principles of human rights are increasingly being raised in investment treaty lawsuits by host states, investors, third-parties, or judges.<sup>15</sup> Both investors and states might violate human rights principles and both of them may invoke these principles in the application or interpretation of investment treaty obligations.<sup>16</sup>

This paper focuses on the potential tension between the investor’s rights and the host state’s capacity to regulate its environmental concerns through enacting legislations to protect the environment without being obliged to compensate the investor for reducing their property values. In certain situations, host states should compensate the investor for the taking of property. The fundamental challenge is to strike a balance between the stability concerns that should surround the investment activities and the need to strengthen environmental regulations.<sup>17</sup>

The reflections that make up this paper are organized under topical headings corresponding to the areas of significant concern. Part I “International Environmental Law” explores the environmental concepts, points out various environmental instruments, identifies

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neither an environmental law framework nor technical infrastructure to tackle the resulting environmental problems. See HUNTER ET AL., *supra* note 2, at 1343.

13. Gaetan Verhoosel, *Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking A “Reasonable” Balance Between Stability and Change*, 29 LAW & POL’Y INT’L BUS. 451, 457-58 (1998).

14. In the context of international trade, the environmental disputes became frequent topics under the General Agreement on Tariffs and Trade (“GATT”), starting with the *Tuna-Dolphin* cases and the environmental damage caused by the 1991 Gulf War generated an unprecedented volume of state responsibility claims that were settled by the UN Security Council’s Compensation Commission (UNCC). See Peter H. Sand, *The Evolution of International Environmental Law in THE OXFORD HANDBOOK OF INTERNATIONAL ENVIRONMENTAL LAW* 36 (Daniel Bodansky et al. eds., 2007).

15. N. Jansen Calamita, David Earnest & Markus Burgstaller, *The Future of ICSID and the Place of Investment Treaties in International law: Investment Treaty Law Current Issues IV*, BRIT. INST. INT’L & COMP. L. 25 (2013).

16. *Id.* at 29.

17. Verhoosel, *supra* note 13, at 453-54.

environmental principles that correlate with investment concepts, and finally examines human rights principles and its relationship with both investment and environment. Part II “International Investment Law” discusses extensively the different concepts and principles governing foreign investments and the environmental issues associated with investment. Part III “Interaction between Investment and Environment” deals with the issues relating to the tension between both bodies of law in theory and in practice. Part IV “Concerns about of Investment-Environment Disputes” discusses a number of concerns that might arise in the investment disputes that involve environmental issues, analyzes the approaches adopted by different tribunals that dealt with such disputes, and points out the lack of transparency in these disputes. Part V “Proposed Regimes” briefly considers the important implications of key development in investment arbitration and proposes some new mechanisms procedurally and substantively that may, in the author’s view, assist in balancing the conflicting interests and address the tension between both bodies of law.

#### INTERNATIONAL ENVIRONMENTAL LAW

International environmental law is neither a separate nor self-contained system but it is part of international law as a whole.<sup>18</sup> There is a lack of coherence in the international environmental system due to the absence of a dedicated international environmental organization and an agreed international dispute settlement process.<sup>19</sup> There are no international bodies dedicated solely to addressing environmental disputes.<sup>20</sup>

#### *Evolution of Environmental Law and Regulation*

In addition to the environmental principles that were escalated to the level of customary international law, a growing number of international environmental treaties have formed a body of international law on environmental protection.<sup>21</sup> Furthermore, international judicial bodies, such as the International Court of Justice (“ICJ”), have started to pay more attention to environmental concerns.<sup>22</sup> A database on

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18. Alan Boyle, *Relationship between International Environmental Law and Other Branches of International Law*, in THE OXFORD HANDBOOK OF INTERNATIONAL ENVIRONMENTAL LAW 126-27 (Daniel Bodansky et al. eds., 2007).

19. *Id.*

20. See *infra* Part IV.

21. Lorenzo Cotula, *Regulatory Takings, Stabilization Clauses and Sustainable Development*, OECD at 10 (2008), <http://www.oecd.org/investment/globalforum/40311122.pdf>.

22. *Id.*

“binding” international environmental agreements contains, as of 2010, over 2,700 relevant treaties, of which 1,538 were bilateral treaties, 1,039 multilateral treaties, and 159 other agreements. Over 2,300 of these treaties were adopted after 1950 and the rate of adoption accelerated significantly during the 1990s.<sup>23</sup>

There are a number of international legal instruments concerning the environment, including the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal<sup>24</sup> and the Declaration of the United Nations Conference on the Human Environment (or Stockholm Declaration).<sup>25</sup> However, the most important international environmental instruments are the Rio Declaration and the Stockholm Declaration.

#### The 1992 Rio Declaration

The leading remarkable environmental instrument on the international sphere is the 1992 Rio Declaration.<sup>26</sup> It articulates the agreed-upon international environmental principles as of 1992.<sup>27</sup> It concerns working towards international agreements which respect the interests of all states and protect the integrity of the global environmental and developmental system.<sup>28</sup>

#### The 1972 Stockholm Declaration

The second leading environmental instrument is the 1972 Stockholm Declaration. It sets forth the basic concepts and principles of environment, such as the importance of reducing pollution as well as integrating environment and development. One of the implicit features of this declaration is that Principle 21 strikes a balance between a state's sovereignty and its obligation not to cause harm to the environment of another state or of the global commons.<sup>29</sup>

States, in signing these declarations, expressed the importance of international cooperation in protecting the global environment.<sup>30</sup> In-

23. Harnessing Freedom of Investment for Green Growth, OECD, at 49 (2010), <http://www.oecd.org/investment/internationalinvestmentagreements/46905672.pdf>.

24. Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, <http://www.basel.int/Portals/4/Basel%20Convention/docs/text/BaselConventionText-e.pdf>.

25. Declaration of the United Nations Conference on the Human Environment (1972), <http://www.unep.org/Documents.Multilingual/Default.asp?documentid=97&articleid=1503>.

26. Rio Declaration on Environment and Development (1992), <http://www.unep.org/Documents.Multilingual/Default.Print.asp?documentid=78&articleid=%201163>.

27. HUNTER, ET AL., *supra* note 2, at 466.

28. Rio Declaration, *supra* note 26.

29. HUNTER, ET AL., *supra* note 2, at 464-65.

30. China has incorporated numerous Rio Declaration principles into domestic Chinese law.

corporating environmental concerns in foreign investments activities is consistent with international environmental commitments by Multi-National Enterprises (“MNEs”) as well as developed and developing nations alike.<sup>31</sup>

### *Principles of Environmental Protection*

Generally, human activities cause serious environmental problems.<sup>32</sup> Environmental protection addresses, among other issues, the sustainable use of natural resources as well as human, animal, and plant health.<sup>33</sup> For example, MNEs often invest in developing countries where they can make profits without compliance to strict regulatory standards that are applied in their home states.<sup>34</sup>

The term “environment” is, in itself, neutral. Texts that talk about the right to environment add a qualifying term to the word “environment.” International instruments,<sup>35</sup> and constitutional instruments<sup>36</sup> qualify the term “environment” by adding a standard to it.<sup>37</sup> The policy adopted by international environmental law emphasizes the prevention and minimization of environmental damage, rather than compensating the damage incurred.<sup>38</sup>

The assemblage of human rights law, environmental law, and international cultural law has developed a number of *erga omnes* obligations that are directed towards the international community as a whole rather than to a specific state on a reciprocal basis, among which is the duty to cooperate in preserving the environment.<sup>39</sup> For instance, members of the international community are required to “take all necessary steps to minimize environmental damage,” “to take all appropriate measures in accordance with good petroleum in-

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31. Benjamin Martin, *An Environmental Remedy to Paralyzed Negotiations for a Multilateral Foreign Direct Investment Agreement*, 1 GOLDEN GATE U. ENVTL. L.J. 209, 263-64 (2007); Jordan C. Kahn, *A Golden Opportunity for NAFTA*, 16 N.Y.U. ENVTL. L.J. 380, 387-88 (2008).

32. HUNTER, ET AL., *supra* note 2, at 15.

33. UNCTAD, ENVIRONMENT, *supra* note 4, at 6.

34. M. Sornarajah, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT, 225 (2010).

35. The Stockholm Declaration mentions the phrase “environment of a quality that permits a life of dignity and well-being.” Stockholm Declaration, *supra* note 25.

36. See Angel Manuel Moreno, *The Right to Environmental Protection in the Spanish Constitutional System*, Avosetta Group (citing that the Spanish Constitution of 1978 provides for “the right to enjoy an adequate environment for the development of the person”), available at <http://www-user.uni-bremen.de/avosetta/morconstright.html>.

37. Dinah Shelton, *Human Rights, Environmental Rights, and the Right to Environment*, 28 STAN. J. INT’L L. 103, 134-35 (1991).

38. Cotula, *supra* note 21, at 10.

39. Valentina S. Vadi, *When Cultures Collide: Foreign Direct Investment, Natural Resources, and Indigenous Heritage In International Investment Law*, 42 COLUM. HUM. RTS. L. REV. 797, 816-17 (2011).

dustry practice,” “to take all reasonable precautions against pollution,” or to ensure that operations are “conducted in a workmanlike manner with reasonable precautions.”<sup>40</sup>

A key tenet of environmental protection is that those who are responsible for harming the environment should bear the cost of protecting it.<sup>41</sup> Accordingly, investors would eliminate the damaging activities to those aimed at meeting the necessities. This is the so-called “internalizing externalities.”<sup>42</sup> Internalizing environmental costs shifts the cost of environmental harm from society as a whole to the person who causes the harm.<sup>43</sup> It would be more economically efficient to establish prescriptive regulations mandating what parties can and cannot do.<sup>44</sup>

Environmental protection could be achieved through the IIAs or the mandatory regulations that apply statutes and rules of conduct.<sup>45</sup> More significant might be the integration of green economy objectives into IIAs and the screening of investments based strictly on environmental criteria that would help in refining a government’s environmentally sustainable objectives.<sup>46</sup> In this way, MNEs and Non-Governmental Organizations (“NGOs”) may contribute significantly to the preservation of the environment. The environmental responsibility of MNEs goes beyond compliance with such standards to the development and maintenance of best practices on environmental restoration, conservation, risk and impact assessment and cooperation with national authorities.<sup>47</sup>

Thus, a set of principles have been developed under the international environmental law to guide states’ behavior regarding sustainability. These principles help in reconciling the highly divergent interests in the area of public policy that demands flexibility, adapta-

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40. Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT’L L.J. 215, n.58 (1996).

41. J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 466 (1999).

42. HUNTER ET AL., *supra* note 2, at 126-27.

43. This is the principle of “polluter pays.” Wagner, *supra* note 41, at 470.

44. HUNTER ET AL., *supra* note 2, at 129. These regulations range from very prescriptive “command-and-control” regulations that require specific technology, to specific processes requirements, to more flexible mechanisms that set emissions limits but allow the firm the flexibility to decide how to achieve them most efficiently.

45. UNCTAD, ENVIRONMENT, *supra* note 4, at 7.

46. UNCTAD, *Trade and Development Board, External evaluation of UNCTAD sub-programme 2: Investment and enterprise*, U.N. Doc. TD/B/WP(68)/CRP.2, at 20 (2014) [http://unctad.org/meetings/en/SessionalDocuments/wpd264\\_en.pdf](http://unctad.org/meetings/en/SessionalDocuments/wpd264_en.pdf).

47. UNCTAD, ENVIRONMENT, *supra* note 4, at 21.



bility, and pluralism.<sup>48</sup> Our main focus will be directed to a number of these principles due to their impact upon investment disciplines, namely, sustainable development, the precautionary principle, the polluter-pays principle, the principle of non-causing environmental harm, and the principle of prevention.

### Sustainable Development

Pursuant to principles 12 of the Rio Declaration<sup>49</sup> and principle 13 of the 1972 Stockholm declaration,<sup>50</sup> states should cooperate to promote the international economic system in order to increase the economic growth and sustainable development to better address environmental degradation. Sustainable development can be defined as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”<sup>51</sup>

Furthermore, it may be defined as “the composition, structure, and distribution of ecosystems that affect the ways in which energy and materials are exchanged.”<sup>52</sup> It links environmental, technological, and social concerns with the economic decision-making process.<sup>53</sup> The Rio Declaration recognizes the supremacy of development<sup>54</sup> and holds states liable for the well-being of citizens and for harm caused to the environment.

### The Precautionary Principle

Principle 15 of the Rio Declaration states that “[i]n order to protect the environment, the precautionary approach shall be widely applied by states according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.”<sup>55</sup> This principle is an integral part of international law. The rationality of this principle is based on the fact that “science does not always provide all relevant information to take protective steps against environmental harm, and that potentially hazardous effects may occur if humanity waits for science to provide the

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48. Marcos A. Orellana, *Science, Risk and Uncertainty*, in *NEW ASPECTS OF INTERNATIONAL INVESTMENT LAW* 713-14 (Philippe Kahn & Thomas W. Walde eds., 2007).

49. Rio Declaration, *supra* note 26.

50. Stockholm Declaration, *supra* note 25.

51. Ahmad, *supra* note 9, at 5-6.

52. Mukul Sanwal, *Sustainable Development, the Rio Declaration and Multilateral Cooperation*, 4 *Colo. J. Int'l Env'tl. L. & Pol'y* 45, 48 (1993).

53. *Id.*

54. *Id.*

55. Rio Declaration, *supra* note 26.

required insights.”<sup>56</sup> In this way, the precautionary principle underscores the need for authorities to protect the environment from potential risks, even if the degree of environmental danger is unknown.<sup>57</sup>

### The Polluter-Pays Principle

Principle 16 of the Rio Declaration indicates that the person who is responsible for pollution - the polluter - should bear the expenses decided by the public authorities to restore the sound state of the environment.<sup>58</sup> It allocates the costs of pollution prevention and control measures to ensure the sound use of environmental resources and avoid destroying foreign investment.

### The Principle of Non-Causing Environmental Harm

Internationally, each state has a general obligation to protect the environment and promote sustainable development. This obligation is reflected in various international instruments as a “principle of common but differentiated responsibilities.”<sup>59</sup> The central principle is the obligation of states not to cause environmental harm, which is generally considered part of customary international law.<sup>60</sup>

### The Principle of Prevention

There is interrelation between the prevention principle and the obligation not to cause environmental harm. Nevertheless, when the involving parties are states, they will often be the same.<sup>61</sup> The prevention principle requires states to anticipate environmental damage and to act prospectively to prevent it.<sup>62</sup> Protection of environment is best achieved when states act as preventers of harm more than

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56. Martin, *supra* note 31, at 261-62.

57. *Id.*

58. Rio Declaration, *supra* note 26; *see also* OECD, Environment Policy Committee, Guiding Principles Concerning the International Economic Aspects of Environmental Policies, Doc. No. C(72)128, 1972 WL 24710.

59. HUNTER, ET AL., *supra* note 2, at 495.

60. *Id.* at 502-03. This obligation has its roots in the common law principle of *sic utere ut alienum non laedus* (i.e., do not use your property to harm another). Additionally, states are obliged not to use their territory directly or indirectly in a way that harm another state's interests, which was extended to environmental damage since 1941 in the well-known *Trail Smelter* arbitration. *Id.*

61. The prevention principle was embodied in Article 3 of the ILC's 2001 Draft Articles on the Prevention of Transboundary Harm from Hazardous Activities, which states that states shall “take all necessary measures to prevent significant transboundary harm or at any event to minimize the risk thereof.”

62. HUNTER ET AL., *supra* note 2, at 507.

as remedial bodies after the occurrence of harm. This is most cost-efficient.

### Environmental Impact Assessment (“EIA”)

States can anticipate the environmental harm by undertaking an Environmental Impact Assessment (“EIA”),<sup>63</sup> which can be defined as a “process for assessing the impact of proposed activities, policies or programs to integrate environmental issues into development planning.”<sup>64</sup> The governmental authorities, under this test, have to identify the environmental effects of the proposed activities on its territory and its citizens.<sup>65</sup> For instance, since 1989 the World Bank has required an EIA before approving the finance of any project financing.<sup>66</sup> The EIA serves two purposes: on the one hand, it is an appropriate method of forcing the preservation of the environment and, on the other hand, it is a tool that helps to avoid future disputes. This practice shows the willingness of FDI players to pay greater attention to environmental concerns in host countries.<sup>67</sup>

Rapidly, the EIA technique, which originated in section 102(c) of the 1970 National Environmental Policy Act, spread to more than 80 countries worldwide and was incorporated into a 1985 Council Directive of the European Union and the 1991 UNECE Convention on Environmental Impact Assessment in a Transboundary Context.<sup>68</sup> This development reflects the success of adopting such technique and introducing it to environmental disputes became a necessity.

### *Evolution of Human Rights Law*

Human rights principles occupy an important position on the international arena. One of the fundamental goals of human rights is to

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63. See *infra* Part V “Proposed Regimes.”

64. HUNTER ET AL., *supra* note 2, at 531.

65. *Id.*

66. Several projects have been modified as a result of an EIA. For example, the developers of the Botswana Tuli Blocks Roads project had to reroute a road in order to preserve an archaeological site. See Vadi, *supra* note 39, at 874-75; Martin, *supra* note 31, at 253-54.

67. The rationale of the EIA was questioned by the *Maffezini* tribunal which affirmed that “the environmental impact assessment procedure is basic for adequate protection of the environment and the application of appropriate environmental measures. This is true not only under Spanish and [European Economic Community] Law, but also increasingly so under international law.” To conclude, the Tribunal held Spain not liable because it had simply required compliance with its environmental laws in a manner consistent with its investment treaty commitments. This award was rendered in the Spanish language, available at [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC566\\_Sp&caseId=C163](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC566_Sp&caseId=C163). The English parts of this award were referred to in Valentina S. Vadi, *supra* note 39, at 875.

68. Sand, *supra* note 14, at 37.

achieve justice and peace. In achieving these ends, there should be a legal recognition of the equal and inalienable rights of all members of the human family.<sup>69</sup> Besides, one of the main goals of the human rights principles is to protect the environment, which simultaneously enhances the protection of human life.

Human rights and environmental protection represent different but overlapping social values. Although violation of environmental principles might be a violation of human rights principles and vice versa, this is not always the case. Environmental issues might also be addressed outside the framework of human rights.<sup>70</sup>

Environmental protection may be addressed through human rights principles by one of the following alternatives. The first approach is to assert that human rights relate to the environment, such as the rights to life, personal security, health, and food. A safe environment could be a pre-condition to those rights because unsound environment affects adversely the enjoyment of these rights. A second approach would be to recognize a specific “right to environment” to the current array of human rights.<sup>71</sup> Additionally, the debate concerns the goals of environmental protection itself - whether to enhance human well-being or whether it has broader goals that subordinate short-term human needs to the overall protection of nature.<sup>72</sup> Starting with the Stockholm Declaration, the right to environment became part of several international and regional human rights instruments.<sup>73</sup> In addition, the Sub-Commission on Prevention of Discrimination and Protection of Minorities of the Economic and Social Council Commission on Human Rights adopted a resolution that referred to the right of all peoples to life and the right of future generations to enjoy their environmental heritage.<sup>74</sup>

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69. Shelton, *supra* note 37, at 106-07.

70. *Id.* at 105.

71. Those alternatives are discussed in Shelton, *supra* note 37, at 105.

72. *Id.* at 107.

73. *Id.* at 125. For example, the 1981 African Charter on Human and Peoples' Rights. The United Nations Economic Commission for Europe (UNECE) drafted the Charter on Environmental Rights and Obligations, which affirms the fundamental principle that everyone has the right to an environment adequate for general health and well-being. The Charter formulates this right primarily by developing the procedural rights of access to information, due process, and participation in decision-making, <http://www.unece.org/leginstr/env.html>.

74. Resolution 1988/26 considered the specific question of the movement of toxic and dangerous products and wastes concerning human rights and scientific and technological developments. See Dinah Shelton, *supra* note 37, at 129.

## INTERNATIONAL INVESTMENT LAW

The law of foreign investments is one of the most significant areas of international law<sup>75</sup> due to the protection it offers to foreign properties in the host states in which the investment is made. It has enjoyed rapid growth in the last decades<sup>76</sup> due to the tremendous tools that were enacted to regulate investment law.<sup>77</sup> Furthermore, it includes not only treaties but also investment contracts between foreign investors and host states (“State Contracts”). However, the misconduct of MNEs reflects a stark imbalance between the extreme protection often accorded to foreign investors and the lesser protection given to the environment of the host states.<sup>78</sup>

Although foreign investors view developing countries as sources for financial profits, they have concerns about their investments in the host states where they would be subject to the state’s lawmaking authority.<sup>79</sup> In order to attract FDI,<sup>80</sup> states usually offer certain forms of protection guarantees, whether substantial or procedural, to foreign investors, which find their sources in national laws, Bilateral Investment Treaties (BITs), Multilateral Investment Treaties (“MITs”), and State Contracts.

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75. Vadi, *supra* note 39, at 822.

76. Surya P. Subedi, *The Challenge of Reconciling the Competing Principles within the Law of Foreign Investment with Special Reference to the Recent Trend in the Interpretation of the Term “Expropriation,”* 40 INT’L LAW. 121, 122 (2006), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1895709](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1895709).

77. These tools include the International Investment Agreements (“IIAs”), which include Bilateral Investment Treaties (“BITs”), Multilateral Investment Treaties (“MITs”), and Regional Investment Treaties. BIT refers to the international treaty that regulates the issues of investment between two state parties only, whereas the MIT functions the same as BIT but between more than two state parties. The number of IIAs has increased steadily from 1959 until 1990 after which the rate jumped. At 1990, the number of BITs in force was 400, leaped to 1,000 in 1995, and reached 1,800 in 2000. See UNCTAD, *Bilateral Investment Treaties 1959-1999*, U.N. Doc. No. UNCTAD/ITE/IIA/2 (2000), <http://unctad.org/en/Docs/poiteiid2.en.pdf>. In 2013, 44 IIAs were concluded, including 30 BITs and 14 other economic cooperation agreements with investment-related provisions. Accordingly, the total number of IIAs reached 3,236 in 2013. In the meantime, several BITs were also terminated in 2013. For example, South Africa gave notice of the termination of its BITs with Germany, the Netherlands, Spain, and Switzerland; Indonesia gave notice of the termination of its BIT with the Netherlands in 2014. See UNCTAD Reports 2014, available at [http://unctad.org/Sections/dite\\_dir/docs/diae\\_stat\\_2014-06-24\\_WIR14\\_en.pdf](http://unctad.org/Sections/dite_dir/docs/diae_stat_2014-06-24_WIR14_en.pdf).

78. Kate Miles, *International Investment Law: Origins, Imperialism and Conceptualizing The Environment*, 21 COLO. J. INT’L ENVTL. L. & POL’Y 1, 25-26 (2010).

79. Choudhury, *supra* note 1, at 779-80.

80. A direct investment enterprise is an enterprise in which a foreign investor owns 10%, less, or more of the ordinary shares. See [http://unctad.org/en/Pages/DIAE/Transnational-corporations-\(TNC\).aspx](http://unctad.org/en/Pages/DIAE/Transnational-corporations-(TNC).aspx).

Historically, FDI was mainly focused in extractive industries in poor developing countries.<sup>81</sup> Nevertheless, FDI has grown over the past forty years to include other kinds of investment.<sup>82</sup> More than 3000 investment treaties were developed in order to provide extensive protection to investors and foster economic development.<sup>83</sup> A quick glimpse over the national investment policymaking in 2013 reveals that governments are more liberal than the past towards promoting foreign investments.<sup>84</sup>

States grant foreign investors various kinds of guarantees to facilitate and protect the regulatory framework of their investment. Due to the importance of the principles governing the investment disputes, our discussion will consider these principles, including national treatment, most-favored nation treatment, fair and equitable treatment, stabilization clauses, and protection from expropriation. A detailed discussion will be devoted to the principle of expropriation and its distinction from regulatory measures.

### *National Treatment*

National treatment can be defined as “a principle whereby a host country extends to foreign investors treatment that is at least as favorable as the treatment that it accords to national investors in like circumstances.”<sup>85</sup> It is a guarantee to foreign investors to enjoy the competitive equality with national investors of the host state. To amount to a violation of the national treatment principle, the regulatory measure has to be discriminatory, that is, to favor national investors over foreign investors.<sup>86</sup> Arbitral tribunals interpret this principle broadly regardless of the words used to describe it.<sup>87</sup> Claimants ad-

81. See [http://unctad.org/Sections/dite\\_dir/docs/diae\\_stat\\_2014-06-24\\_WIR14\\_en.pdf](http://unctad.org/Sections/dite_dir/docs/diae_stat_2014-06-24_WIR14_en.pdf).

82. The investment of developing and transition economies was \$553 billion, or 39%, of global FDI outflows, compared to 12% only in the early 2000s. See UNCTAD-Global Investment Trends Monitor 2014, at 1, [http://unctad.org/en/PublicationsLibrary/webdiaeia2014d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaeia2014d1_en.pdf).

83. Vadi, *supra* note 39, at 822.

84. The overall share of regulatory or restrictive investment policies increased from 25% in 2012 to 27% in 2013. See UNCTAD World Investment Report 2014, available at [http://unctad.org/Sections/dite\\_dir/docs/diae\\_stat\\_2014-06-24\\_WIR14\\_en.pdf](http://unctad.org/Sections/dite_dir/docs/diae_stat_2014-06-24_WIR14_en.pdf).

85. UNCTAD, NATIONAL TREATMENT, U.N. Sales No. E.99.II.D.16 (1999), <http://unctad.org/en/docs/psiteiitd11v4.en.pdf>.

86. Ronald S. Lauder v. Czech Republic, Final Award, 9 International Centre for Settlement of Investment Disputes (ICSID) Reports 66, para. 220 (2001), available at <http://www.italaw.com/documents/LauderAward.pdf>.

87. RUDOLF DOLZER & CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 180 (2008).

vanced national treatment claims in ten decided cases and were upheld in four cases under the ICSID Additional Facility Rules.<sup>88</sup>

Nevertheless, the legal requirement for breaching this standard is unclear as to whether the discriminatory measure requires only a less favorable treatment to the foreign investor or whether the foreign nationality has to be the basis for such discrimination.<sup>89</sup> Some tribunals find less favorable treatment is sufficient to uphold a breach of this standard.<sup>90</sup> However, the measure should be geared directly towards the foreign investor to be discriminatory.<sup>91</sup> Therefore, the foreign nationality should be the basic motivation for issuing the discriminatory measure that favors nationals over non-nationals.

Furthermore, tribunals differ in their requirements of intent as an element of discriminatory measures. While some tribunals seem to focus on the practical impact of the discriminatory measure,<sup>92</sup> others require the clear intent to discriminate against foreign investors to constitute a breach of this principle.<sup>93</sup> However, the intent is not necessary as long as the measure results in discriminatory treatment because intent is too difficult to prove.

### *Most-Favored Nation Treatment*

Most-favored nation treatment (“MFN”) is always associated with the national treatment principle, mostly in a single provision.<sup>94</sup> MFN obliges the host state not to treat one foreigner’s investment less favorably than that of an investor from another foreign country.<sup>95</sup> It requires a “comparison between the treatment afforded to two foreign

88. LUCY REED, JAN PAULSSON & NIGEL BLACKABY, *GUIDE TO ICSID ARBITRATION* at 83 (2010).

89. David A. Gantz, *Potential Conflicts Between Investor Rights and Environmental Regulation Under NAFTA’s Chapter 11*, 33 GEO. WASH. INT’L L. REV. 651, 677 (2001).

90. *International Thunderbird Gaming Corp. v. Mexico*, Arbitral Award, para. 177 (2006), <http://www.italaw.com/documents/ThunderbirdAward.pdf>.

91. *GAMI v. Mexico*, Final Award, para. 114-15, where the Tribunal found “the solvency of an important local industry to be a legitimate policy goal and underlined that the relevant measures were not geared towards foreign investor” (2004), <http://www.state.gov/documents/organization/38789.pdf>.

92. *S.D. Myers, Inc. v. Canada*, First Partial Award, para. 254 (2000), <http://www.italaw.com/documents/SDMeyers-1stPartialAward.pdf>. In *Siemens v. Argentina*, Award, para. 321, the Tribunal states that “[t]he Tribunal concurs that intent is not decisive or essential for a finding of discrimination, and that the impact of the measure on the investment would be the determining factor” (2007), <http://www.italaw.com/documents/Siemens-Argentina-Award.pdf>.

93. *Genin v Estonia*, Award, (ICSID Case No. ARB/99/2), 17 ICSID Review-FILJ (2002) 395, para. 369 (2001), <http://www.italaw.com/documents/Genin-Award.pdf>.

94. For Example, Article 2(1) of the US-Argentina BIT and Article 7 of the Model UK BIT.

95. REED ET AL., *supra* note 88, at 82.

investors in like circumstances.”<sup>96</sup> This principle acts as an additional guarantee of equality and non-discrimination.<sup>97</sup> Although this principle concerns primarily substantive rights, such as fair and equitable treatment<sup>98</sup> and the standard of compensation in expropriation cases,<sup>99</sup> some tribunals have used it to overcome jurisdictional and procedural issues by borrowing procedural provisions from other BITs, especially the provision of a dispute settlement mechanism.<sup>100</sup> However, other tribunals are reluctant to extend the MFN clause to procedural rights.<sup>101</sup> Nevertheless, tribunals should be cautious in invoking the MFN clause to benefit from provisions of third treaties (that are not related to the parties of the dispute) and should limit such practice to comparable treaties pursuant to the subject matter, such as investment treaties. Otherwise, the ‘like-circumstances’ or ‘like-situations’ case would be difficult to prove.

### *Fair and Equitable Treatment (“FET”)*

BITs typically call for “fair and equitable treatment” to be afforded to foreign nationals, but do not define the term. Rather, they leave room for the tribunals to reviewing the “fairness” and “equity” of the

96. UNCTAD, MOST-FAVoured NATION TREATMENT (2010), [http://unctad.org/en/docs/diaeia20101\\_en.pdf](http://unctad.org/en/docs/diaeia20101_en.pdf).

97. *Id.* at 1.

98. Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan (ICSID Case No. ARB/03/29) (2001). *available at* [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC523\\_En&caseId=C27](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC523_En&caseId=C27). The Tribunal referred to the general possibility to “import” a fair and equitable treatment provision contained in another BIT that was cited in Pope & Talbot Inc. v. Canada (2001).

99. The Tribunal in *CME* held that “[t]he determination of compensation under the Treaty between the Netherlands and the Czech Republic on basis of the ‘fair market value’ finds further support in ‘the most favored nation’ provision of Art. 3(5) of the Treaty.” *CME Czech Republic B.V. v. Czech Republic*, Final Award, para. 500, at 116 (2003), [http://italaw.com/documents/CME-2003-Final\\_001.pdf](http://italaw.com/documents/CME-2003-Final_001.pdf).

100. REED ET AL., *supra* note 88, at 85. The first ICSID case that adopted this approach is Emilio Agustín Maffezini v. Kingdom of Spain (ICSID Case No. ARB/97/7) (2000). This award is published in the Spanish language and the relevant parts were translated as follows “[A]n Argentina investor filed an ICSID claim against Spain, although he had not previously submitted the dispute to the Spanish courts as required by the Argentina-Spain BIT. He argued, however, that he could by-pass this precondition to ICSID arbitration by invoking the MFN clause of the Argentina-Spain BIT to claim an equally favorable benefit under Spain’s BIT with Chile, which does not require investors to seek prior recourse in local courts. The ICSID tribunal agreed, holding that, on the basis of the MFN clause in the Argentina-Spain treaty, the Argentina investor could rely on the less stringent procedural provisions of the Chile-Spain BIT.” *Id.*

101. Plama Consortium Limited v. Republic of Bulgaria (ICSID Case No. ARB/03/24), para.146-51 (2005), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC521\\_En&caseId=C24](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC521_En&caseId=C24); Telenor Mobile Communications AS v. Republic of Hungary (ICSID Case No. ARB/04/15), Award, para. 56 (2006), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC652\\_En&caseId=C240](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC652_En&caseId=C240).



actions of the host state in light of all the circumstances of each case.<sup>102</sup> FET is a difficult standard to define in precise legal terms. It functions as a gap-filler for other standards.<sup>103</sup> However, it is distinctive from other standards; there might be an FET violation without violating other standards.

Furthermore, FET arguably provides protection beyond the minimum standards provided by customary international law.<sup>104</sup> The Free Trade Commission ("FTC") of NAFTA<sup>105</sup> interpreted "FET" as requiring the same treatment that is required by the minimum standard of treatment for aliens under customary international law.<sup>106</sup> NAFTA tribunals adopted the same approach as the FTC<sup>107</sup> and many subsequent BITs followed the FTC approach.<sup>108</sup> In applying the FET, the tribunals identified typical factual situations to which the principle should apply, such as transparency,<sup>109</sup> investor's legitimate expectations, compliance with contractual obligations,<sup>110</sup> due process and procedural fairness,<sup>111</sup> and good faith.<sup>112</sup>

### *Stabilization Clauses*

Stabilization clauses became a permanent feature of BITs and national investment laws. Stabilization clauses provide that any future

102. REED ET AL., *supra* note 88, at 74.

103. DOLZER & SCHREUER, *supra* note 87, at 122.

104. *See generally id.* at 124-25.

105. For more details about NAFTA, see *infra* Part III(C)(1).

106. NAFTA, Article 1104: Standard of Treatment, [http://www.sice.oas.org/tpd/nafta/Commission/CH11\\_understanding\\_e.asp](http://www.sice.oas.org/tpd/nafta/Commission/CH11_understanding_e.asp).

107. *Pope & Talbot*, *supra* note 98, para. 17-69 (2001); *Methanex Corp. v. USA*, Final Award, para. 17-24 (2005).

108. These include Chile-United States FTA Article 10.4 (2003); United States-Uruguay BIT Article 5 (2004); and Canada Model BIT Article 5.

109. DOLZER & SCHREUER, *supra* note 87, at 133-34; *see also infra* Part IV(B).

110. It is closely related to investor's legitimate expectation. Applying the *Pacta sunt servanda* enhances the stability requirements of the FET standard. A number of tribunals decided that violating contractual arrangements violates the legitimate expectation of the investor, but the question remains whether any contractual violation amounts to FET violation. Tribunals vary in their approaches. Some of them take a more restrictive approach beyond a simple breach, such as *Consortium RFCC v Morocco* (ICSID Case No. ARB/000/6) (a French award) (only measures taken by Morocco in its sovereign capacity are capable of breaching FET; ordinary violations do not rise to violating FET), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC613\\_Fr&caseId=C193](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC613_Fr&caseId=C193). Other tribunals consider any contractual violation a FET violation, such as *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award (2002).

111. *See infra* Part IV(B).

112. The tribunals that upheld the FET violations based their decisions on a combination of these elements of FET, namely, transparency, legitimate expectation, contractual obligations, or due process. In addition, there are no reported cases that upheld the environmental damage as conduct to be weighed against an alleged breach of the FET standard.

changes in the host state's law that may result in disadvantages to foreign investors will not be applied to them.<sup>113</sup> They are incorporated basically by investors in the state contracts to promote the regulatory investment stability during the long-term life period of the investment against any form of taking.

Stabilization clauses may be classified into three categories: a) *freezing clauses* which "freeze" the laws of the host state with respect to the investment project during the project life;<sup>114</sup> b) *economic equilibrium clauses*, which require the investor to comply with new laws with compensation for the cost of complying with those laws, but exemptions from complying with the new laws are not specifically mentioned in the contract;<sup>115</sup> and c) *hybrid clauses*, which require the state to restore the investor to the same position it had prior to changing the law, including, as stated in the contract, exemptions from new laws.<sup>116</sup>

Basically, stabilization clauses oblige the host states not to change the regulatory framework in a way that affects the economic equilibrium of the project; otherwise, it should compensate the investor.<sup>117</sup> From an environmental perspective, these clauses could result in undeveloped countries remaining undeveloped because they already lag behind in their laws and will not be able to upgrade them to meet international standards.<sup>118</sup> In addition, excluding the ongoing investments or prospective investments from the regulatory legal framework of the host state may affect the coherence of the overall legal framework because similar investment projects may be governed by different rules.<sup>119</sup>

Besides, stabilization clauses may put the host state in a position of dealing with unknown future environmental hazards without having the appropriate means of combatting them.<sup>120</sup> States may issue envi-

113. DOLZER & SCHREUER, *supra* note 87, at 75.

114. *Stabilization Clauses and Human Rights*: A research project conducted for IFC and the United Nations Special Representative of the Secretary-General on Business and Human Rights, at vii (2009), <http://www.ifc.org/wps/wcm/connect/9feb5b0048855eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES>.

115. *Id.*

116. *Id.* "Forty-four of the 75 (about 59%) contracts and models in the study from non-OECD countries give exemptions or offer an opportunity for compensation for compliance with all new laws, including environmental and social laws. None of the OECD country contracts or models in the study offer exemptions from new laws, while only two of 13 (about 15 percent) of contracts and models from the OECD offer an opportunity to claim compensation for compliance with all new laws, including environmental and social laws." *Id.* at ix.

117. Cotula, *supra* note 21, at 2.

118. HUNTER ET AL., *supra* note 2, at 1352-53.

119. Cotula, *supra* note 21, at 11.

120. *Id.*

ronmental regulations or impose environmental fiscal instruments, such as levies or charges to protect its environment from such hazards and to adapt to the changing environmental conditions or its international law obligations to comply with evolving international environmental laws.<sup>121</sup> This would contradict its obligation under the contractual stabilization clause (*pacta sunt servanda*).

New environmental obligations may be developed or changed in different ways. New techniques of environmental assessment may be introduced under existing laws, new interpretations of environmental law, or completely new or amended environmental legislations.<sup>122</sup> Such unforeseen changes in content, scope, and impact may be induced by the emergence of new technologies or international standards, the reasonable dealing with the damages caused by the project, or political influence from environmental organizations.<sup>123</sup> Stabilization clauses may, arguably, trigger the state's obligations towards the investor to pay full restitution or require compensation for breach of the agreement.<sup>124</sup>

### *Expropriation*

The importance of expropriation emanates from its impact upon the investment property. It deprives the investor of the possession of the investment property, physically or economically. First, I will define expropriation and discuss its elements. Then, I will explain the difference between direct and indirect expropriation. I will also discuss the difference between the regulatory measures and the expropriatory measures.

### Definition of Expropriation

Expropriation generally refers to "property-specific or enterprise-specific takings where the property rights remain with the state or are transferred by the state to other economic operators."<sup>125</sup> Expropriation may be defined as the state's sovereign right to control all the property by any means, including "taking" or destruction, within its territory whether owned by nationals or aliens.<sup>126</sup>

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121. *Id.* at 12.

122. Waelde & Ndi, *supra* note 40, 230-31.

123. *Id.*

124. *Id.* at 243-44.

125. UNCTAD, EXPROPRIATION, at 5-6 (2012), [http://unctad.org/en/Docs/unctaddiaeia2011d7\\_en.pdf](http://unctad.org/en/Docs/unctaddiaeia2011d7_en.pdf).

126. The problem with expropriation is not that straightforward as states do not usually interfere through this direct formal expropriation, but they interfere without the formal taking of property.

From an investor's perspective, expropriation is the most extreme form of interference by the host state with the foreign investment. From the host state's perspective, it is a fundamental right that indicates natural application of its territorial sovereignty over any property located in its territory, including alien property. The right of compensation for expropriation finds its basis in customary international law. Virtually, all the BITs to date contain an expropriation provision.<sup>127</sup>

In order for the expropriation to be lawful, a number of conditions have to be met: (a) property has to be taken for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law; (d) accompanied by prompt, adequate, and effective compensation.<sup>128</sup> Absent one of these conditions, the expropriation will be unlawful.

### Direct versus Indirect Expropriation

Expropriation may be direct or indirect. Direct expropriation means "a mandatory legal transfer of the title to the property or its outright physical seizure."<sup>129</sup> It involves an intentional formal transfer of title through enacting legislations or physical act of taking over the investment from the investor. On the other hand, indirect expropriation, sometimes called "creeping," "disguised," "constructive," "consequential," "regulatory," or "virtual" expropriation,<sup>130</sup> refers to the state's interference in the use or enjoyment of the investment to deprive the investor from the benefits of the property, though the legal title of the property remains with the investor.<sup>131</sup> While all IIAs refer explicitly to direct expropriation, some of them do not refer explicitly to indirect expropriation.<sup>132</sup> Sometimes, they refer to indirect expropriation using phrases such as "having effect equivalent to . . . expropriation," "any direct or indirect measure" of expropriation, "any

127. UNCTAD, EXPROPRIATION, *supra* note 125, at 5; David A. Gantz, *Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA*, 31 ELR 10646, 10662 (2001).

128. UNCTAD, EXPROPRIATION, *supra* note 125, at 1; DOLZER & SCHREUER, *supra* note 87, at 91.

129. UNCTAD, EXPROPRIATION, *supra* note 125, at 6.

130. H. Hamner Hill, *NAFTA and Environmental Protection: The First 10 years*, J. INST. JUST. INT'L STUD. 157, 158 (2006); UNCTAD, EXPROPRIATION, *supra* note 125, at 11.

131. Choudhury, *supra* note 1, at 792; Kyla Tienhaara, *What You Don't Know Can Hurt You: Investor-State Disputes and the Protection of the Environment in Developing Countries*, 6 GLOBAL ENVTL. POL., no. 4, 2006, at 1, 8, available at <http://ssrn.com/abstract=1740085>; UNCTAD, EXPROPRIATION, *supra* note 125, at 11.

132. The Lebanon-Malaysia (BIT) (2002), <http://investmentpolicyhub.unctad.org/Download/TreatyFile/1887>.

other measure having the same nature or the same effect against investments,” or “all other measures whose effect is to dispossess, directly or indirectly, the investors.”<sup>133</sup> However, absence an explicit reference, expropriation is defined broadly enough to cover both direct and indirect taking.<sup>134</sup>

Indirect expropriations should have the following cumulative elements: (a) an act attributable to the state; (b) interference with property rights or other protected legal interests; (c) of such degree that the relevant rights or interests lose all or most of their value or the owner is deprived of control over the investment; (d) even though the owner retains the legal title or remains in physical possession.<sup>135</sup> Predictably, what constitute indirect expropriation is difficult to determine and arbitral tribunals interpret it on a case-by-case basis.<sup>136</sup> However, an indirect expropriation should have an equivalent effect to a direct expropriation, that is, to render the property rights useless and deprive the owner of the economic use of the investment.<sup>137</sup>

Indirect expropriation might be *de facto* or *de jure* expropriation. In *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States*<sup>138</sup> where the Claimant, Tecmed, was awarded a tender for the sale of real property, buildings, and facilities, and other assets relating to “Cytrar,” a landfill of hazardous industrial waste,<sup>139</sup> which had a renewable license to operate for a five-year term. In 1994, the license became operable for an indefinite period of time.<sup>140</sup> The landfill then became the property of the government<sup>141</sup> and the license terms were amended to be for only one year subject to renewal.<sup>142</sup> In 1998, the government refused to renew the license.<sup>143</sup> The Claimant initiated an expropriation claim against Mexico.<sup>144</sup>

The Tribunal, in determining the expropriatory measure, considered whether such a measure was proportional to the public interest pre-

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133. Wagner, *supra* note 41, at 472-73.

134. Article 1110 of NAFTA. Environmentalists believe that environmental regulations may be successfully challenged as indirect expropriations. See Hill, *supra* note 130, at 158.

135. UNCTAD, EXPROPRIATION, *supra* note 125, at 12.

136. Gantz, *supra* note 127, at 10662.

137. UNCTAD, EXPROPRIATION, *supra* note 125, at 63.

138. *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States*, (ICSID Case No. ARB (AF)/00/2), Award (2003), [http://www.italaw.com/sites/default/files/casedocuments/ita085\\_4.pdf](http://www.italaw.com/sites/default/files/casedocuments/ita085_4.pdf).

139. *Id.* para. 35.

140. *Id.* para. 36.

141. *Id.* para. 37.

142. *Id.* para. 38.

143. *Id.* para. 39.

144. *Tecmed* decision, *supra* note 138, para. 93.

sumably protected thereby and to the protection legally granted to investments<sup>145</sup> without considering the motivation for issuing the legislation that failed to renew the permit for a landfill site due to environmental concerns.<sup>146</sup>

The Tribunal held that:

a measure could be a de facto indirect expropriation by its effects when the measure was adopted by the state, whether being of a regulatory nature or not, was permanent and irreversible, and the assets and rights object of such a measure were affected in such a way that was impossible to exploit such assets and rights, thus depriving them of any economic value.”<sup>147</sup> (all emphases added).

The Tribunal found that the Respondent breached its obligations under the Agreement set forth in Articles 4(1) and 5(1).<sup>148</sup> Accordingly, the measure for non-renewal of the landfill was not justified by environmental protection.

### Regulatory Taking and Expropriatory Measures

In regulating their public interests, states may take measures or acts that lead to a significant impairment of businesses.<sup>149</sup> States may be able to avoid paying compensation if they exercise their police powers.<sup>150</sup> According to the doctrine of police powers, certain acts of states are not subject to compensation under international law of expropriation.<sup>151</sup> However, the question remains whether there is a heightened standard of review for state measures that result in the economic destruction of an investment.<sup>152</sup> In addition, what is the difference between these regulatory measures that do not give rise to compensation and expropriatory measures that give rise to compensation?

There is no comprehensive definition of what constitutes a regulatory taking measure. However, some authors define regulatory taking as “takings of property that fall within the police powers of a state, or

145. *Id.*, para. 122.

146. Choudhury, *supra* note 1, at 794.

147. *Tecmed* decision, *supra* note 138. The original award is published in the Spanish language. These quotes are derived from the Introductory Note 154,155, [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC4873\\_En&caseId=C3785](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC4873_En&caseId=C3785).

148. *Id.* para. 201.

149. UNCTAD, EXPROPRIATION, *supra* note 125, at 12-13.

150. Andrew Newcombe, *The Boundaries of Regulatory Expropriation in International Law*, in *NEW ASPECT OF INTERNATIONAL INVESTMENT LAW* 429 (Philippe Kahn & Thomas W. Walde eds., 2007).

151. UNCTAD, EXPROPRIATION, *supra* note 125, at 79.

152. Newcombe, *supra* note 150, at 429.

otherwise arise from state measures like those pertaining to the regulation of the environment, health, morals, culture or economy of a host country.”<sup>153</sup> Under international law, regulatory taking is addressed under the rubric of “expropriation.” However, not all regulatory measures are tantamount to expropriatory measures.<sup>154</sup> Thus, the European Court of Human Rights found no expropriation where the investor did not totally lose the peaceful enjoyment of property possession as long as he could continue to utilize their possession as well as the possibility of selling the property subsisted.<sup>155</sup>

Generally, a state is not liable to pay compensation to the injured party as a consequence of ‘bona fide regulation’ within the accepted police powers of states.<sup>156</sup> The Tribunal in *Saluka Investments v. Czech Republic*, confirmed this view by stating that “[i]t is now established in international law that states are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.”<sup>157</sup> However, “[t]here is no set formula to determine where regulation ends and taking begins.”<sup>158</sup>

States enjoy a broad discretion, under customary international law, in regulating the environmental protection and public morals as long as they exercise such powers on a fair, just, and non-discriminatory basis.<sup>159</sup> The U.S. Supreme Court delineated the borders through which the concept of police power may work by stating that the police power cannot go beyond the limit of:

. . . what is *necessary* and *reasonable* for guarding against the evil which injures or threatens the public welfare in the given case, and that the legislature cannot, under the guise [of that power]. . . strike down innocent occupations and invade private property, the destruction and invasion of which are not reasonably necessary to accomplish the needed. . . reform . . . . Where the occupation . . . is in

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153. Tienhaara, *supra* note 131, at 8.

154. The government conduct may affect foreign investment adversely through the passage of an environmental regulation that has a disparate and adverse financial impact upon foreign investors. See Susan D. Franck, *Empirically Evaluating Claims About Investment Treaty Arbitration*, 86 N.C. L. REV. 1, 9 (2007).

155. Wagner, *supra* note 41, at 524.

156. *Id.* at 517-18.

157. *Saluka Investment v. Czech Republic*, para. 255 92006, available at <http://www.italaw.com/sites/default/files/case-documents/ita0740.pdf>.

158. While a comparison of values of the assets before and after issuing the measure might be relevant, it is by no means conclusive. *Goldblatt v. Town of Hempstead*, N. Y., 369 U.S. 590, 594 (1962).

159. UNCTAD, *EXPROPRIATION*, *supra* note 125, at 81.

itself immoral, [there can be] no question of the power of the legislature.<sup>160</sup> (emphasis added)

Moreover, in some BITs, it is provided that expropriation should be only for public purpose related to internal needs of the host state.<sup>161</sup>

In *Methanex Corp. v. USA*,<sup>162</sup> the Tribunal found no expropriation because the investor retained control of its subsidiaries and remained able to sell gasoline additive outside the state of California.<sup>163</sup> The Tribunal decided that the “California ban was made for a public purpose, was non-discriminatory and was accomplished with due process. Hence, Methanex’s central claim under Article 1110(1) of expropriation under one of the three forms of action in that provision fails. From the standpoint of international law, the California ban was a lawful regulation and not an expropriation.”<sup>164</sup>

However, there are a number of factors that might be taken into account in determining the non-compensable regulatory measures and the expropriatory measures.

The first factor is the “degree of interference.” In *Nykomb Synergetics v. Latvia*, the tribunal found that “‘regulatory takings’ may under the circumstances amount to expropriation or the equivalent of an expropriation. The decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail.”<sup>165</sup> In testing expropriation, international tribunals have relied on “substantial deprivation” that severely interferes with the utility of the investment property. In *Vivendi v. Argentina*, the tribunal observed: “The weight of authority . . . appears to draw a distinction between only a partial deprivation of value (not an expropriation) and a complete or near complete deprivation of value (expropriation).”<sup>166</sup> Regulatory measures do not normally reach the threshold of a ‘substantial deprivation.’<sup>167</sup> For instance, in *Feldman v. Mexico*, an exporter of cigarettes from Mexico was allegedly denied tax refund benefits. The

160. *Mugler v. Kansas*, 123 U.S. 623 (1887).

161. Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 NW. J. INT’L L. & BUS. 327, 356 (1994).

162. *Methanex Corp. v. United States of America*, Final Award (2005), <http://www.state.gov/documents/organization/51052.pdf>.

163. *Id.* para. 1-2.

164. *Id.* para. 15; Hill, *supra* note 130, at 165-66.

165. *Nykomb Synergetics Technology Holding AB v. The Republic of Latvia*, Arbitral Award, para. 4.3.1 (2003), <http://www.italaw.com/sites/default/files/case-documents/ita0570.pdf>.

166. *Compania de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, (ICSID Case No. ARB/97/3), Award, para. 7.5.11 (2007), <http://www.italaw.com/sites/default/files/case-documents/ita0215.pdf>.

167. UNCTAD, EXPROPRIATION, *supra* note 125, at 64.



Tribunal found that there was no expropriation (although it found a breach of the national treatment provision) since “the regulatory action . . . has not deprived the claimant of control of . . . [his company], interfered directly in the internal operations of . . . [the company] or displaced the Claimant as the controlling shareholder.”<sup>168</sup>

Second, the “nature, purpose and character” of a measure are important factors in distinguishing between the indirect expropriation and the non-compensable regulatory taking.<sup>169</sup> If there is no legitimate public purpose in the regulation, the measure should be compensable. The approach adopted by the U.S. Model BIT<sup>170</sup> provides that all the governmental measures that are issued for public purposes on a non-discriminatory basis should not be compensated.<sup>171</sup> Accordingly, it is argued that environmental measures would fall under the rubric of public purpose and thus should not be compensable regardless of their impact on foreign investment.<sup>172</sup> However, this approach would give the states carte blanche to expropriate any foreign investment on the basis of public purposes. Nevertheless, tribunals recognized the investor’s right to get compensation against expropriation even if it was motivated by public purpose.<sup>173</sup>

The Tribunal in *S.D. Myers, Inc. v Canada*<sup>174</sup> addressed the distinction between a compensable expropriation and the non-compensable regulatory measure in addition to discussing the purpose of the measure. The Claimant in this case, S.D. Myers, Inc. (“SDM”), was a U.S. corporation that claimed compensation against Canada as a result of the latter’s closure of the borders to trans-boundary movements of

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168. Marvin Feldman v. Mexico, (ICSID Case No. ARB(AF)/99/1), Award, para. 152 (2002), [http://www.economia.gob.mx/files/comunidad\\_negocios/solucion\\_controversias/inversionista-estado/casos\\_concluidos/Marvin\\_roy\\_Feldman\\_Karpa/laudo\\_ingles.pdf](http://www.economia.gob.mx/files/comunidad_negocios/solucion_controversias/inversionista-estado/casos_concluidos/Marvin_roy_Feldman_Karpa/laudo_ingles.pdf).

169. UNCTAD, EXPROPRIATION, *supra* note 125, at 76.

170. There are some exceptions to non-discriminatory actions that are aimed to protect legitimate objectives, such as the environment.

171. Justin R. Mariles, *Public Purpose, Private Losses: Regulatory Expropriation and Environmental Regulation in International Investment Law*, 16 J. TRANSNAT’L L. & POL’Y 275, 309 (2007).

172. *Id.*

173. For example, protecting the antiquities is a matter of public purpose of the state in compliance with its international law obligations and the investor should be entitled to compensation for any expropriation regulation justified by protecting antiquities. An ICSID tribunal held that “[t]he rules of Egyptian law and international law governing the exercise of the right of eminent domain impose an obligation to indemnify parties whose legitimate rights are affected by such exercise . . . . The obligation to pay fair compensation in the event of expropriation applies equally where antiquities are involved.” This case is known as Pyramids Case, Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt (ICSID Case No. ARB/84/3) 375 (1992), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC671\\_En&caseId=C135](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC671_En&caseId=C135).

174. *S.D. Myers*, *supra* note 92.

polychlorinated biphenyl (“PCBs”)<sup>175</sup> and PCB wastes. SDM had a business of disposal of PCB contaminated wastes and sought to import PCBs from Canada to the U.S. to expand its disposal business. In 1977, Canada added PCBs to the toxic substances and prohibited its use in new products manufactured in or imported into Canada.<sup>176</sup> In the U.S., PCBs are primarily regulated under the federal Toxic Controlled Substances Act (“TCSA”) within certain restrictions with the exception of granting an operator exemption for one year if the activity would not result in unreasonable risk to human health or the environment.<sup>177</sup> Canada became a party to the Basel Convention by which it is obliged to ensure that hazardous wastes are managed in an environmentally sound manner.<sup>178</sup> In 1990, SDM began its efforts to obtain the necessary approvals to import from Canada electrical transformers and other equipment containing PCB wastes into the U.S. .<sup>179</sup> Canada’s policy, in line with the Basel Convention, was simply that disposal of PCBs should take place in Canada.<sup>180</sup> However, the Environmental Protection Agency (“EPA”) issued an “enforcement discretion” for the purpose of importing PCBs and PCB waste from Canada into the U.S. for disposal.<sup>181</sup> In 1995, SDMI was not able to receive PCB from Canada for sixteen months due to the banning of exports from Canada to the U.S and Canada’s closure of the border.<sup>182</sup> SDMI claimed that Canada has violated its obligations under NAFTA.<sup>183</sup> The Tribunal, in discerning the purpose for issuing the measure, stated that

Canada’s policy was shaped to a very great extent by the desire and intent to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals . . . the Tribunal is satisfied that the Interim Order and the Final Order favoured Canadian nationals over non-nationals. The Tribunal is satisfied further that the practical effect of the Orders was that SDMI and its investment were prevented from carrying out the business they planned to undertake, which was a clear disadvantage in comparison to its Canadian competitors . . . The Tribunal finds that there was no legitimate environmental reason for introducing the ban. Insofar as there was an

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175. PCB is a chemical compound that was mainly used in electrical equipment.

176. *S.D. Myers*, *supra* note 92, para. 100.

177. *Id.*, para. 102.

178. *Id.*, para. 107.

179. *Id.*, para. 109.

180. *S.D. Meyers*, *supra* note 92, para. 116.

181. *Id.*, para. 118-19.

182. Terri L. Lilley, *Keeping Nafta “Green” for Investors and the Environment*, 75 S. CAL. L. REV. 727, 735-36 (2002).

183. *S.D. Myers*, *supra* note 92, para. 130-31.

indirect environmental objective - to keep the Canadian industry strong in order to assure a continued disposal capability - it could have been achieved by other measures.<sup>184</sup>

The Tribunal decided that the Interim Order and the Final Order banning export of PCBs were ‘regulatory acts’ not amounting to expropriation.<sup>185</sup> It added:

Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference. The distinction between expropriation and regulation screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs. An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary. In this case the closure of the border was temporary . . . [I]t does not support the proposition on the facts of this case that the measure should be characterized as an expropriation within the terms of Article 1110 . . . It must look at the real interests involved and the purpose and effect of the government measure.<sup>186</sup>

The Tribunal decided that Canada’s ban, although not tantamount to expropriation, was a breach of its obligations under NAFTA that caused harm to SDM and should be compensated.<sup>187</sup>

The *Myers* decision was criticized in *Azurix v. Argentina*<sup>188</sup> where the Tribunal found that the presence of a public purpose is not by itself sufficient for determining whether compensation is owed. In 1996, Azurix AGOSBA S.R.L. (“AAS”) and Operadora de Buenos Aires S.R.L. (“OBA”) won the bid for a 30-year concession to provide potable water and sewage services in the Province of Buenos Aires. They incorporated Azurix Buenos Aires S.A. (“ABA”) to act as concessionaire.<sup>189</sup> On March 12, 2002, the Province terminated the Concession Agreement, alleging ABA’s fault.<sup>190</sup> Azurix initiated an ICSID arbitration against Argentina seeking approximately US\$600 million in compensation. The Tribunal decided that:

the issue is not so much whether the measure concerned is legitimate and serves a public purpose, but whether it is a measure that,

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184. *Id.*, para. 162, 193 & 195.

185. *Id.*, para. 281.

186. *Id.*, para. 282-84 & 286-87.

187. *Id.*, para. 301.

188. *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12), Award (2006), <http://italaw.com/documents/AzurixAwardJuly2006.pdf>.

189. *Id.*, para. 38-45.

190. *Id.*, para. 245.

being legitimate and serving a public purpose, should give rise to a compensation claim. In the exercise of their public policy function, governments take all sorts of measures that may affect the economic value of investments without such measures giving rise to a need to compensate . . . . The argument made by the *S.D. Myers* tribunal is somehow contradictory. According to it, the BIT would require that investments not be expropriated except for a public purpose and that there be compensation if such expropriation takes place and, at the same time, regulatory measures that may be tantamount to expropriation would not give rise to a claim for compensation if taken for a public purpose. The public purpose criterion as an additional criterion to the effect of the measures under consideration needs to be complemented.<sup>191</sup>

The Tribunal deemed the “public purpose” criterion as insufficient and added additional elements that may provide useful guidance to decide whether regulatory measures would be expropriatory and give rise to compensation.<sup>192</sup> Furthermore, there should be a “real risk” of harming the environment, which qualifies the measure to be issued for a legitimate public purpose, not a disguised, “unreal” purpose. Accordingly, the Tribunal in *Tecmed*<sup>193</sup> decided that “the absence of any evidence that the operation of the Landfill was a real or potential threat to the environment or to the public health . . . do not constitute a real crisis or disaster of great proportions, triggered by acts or omissions committed by the foreign investor or its affiliates.”<sup>194</sup>

However, in *Santa Elena v Costa Rica*,<sup>195</sup> where Compañía del Desarrollo de Santa Elena, S.A., the Claimant, claimed compensation

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191. *Id.*, para. 310-11.

192. The Tribunal cited the *James* case in the European Court of Human Rights to refer to the additional elements to be taken into consideration by stating that “a measure depriving a person of his property [must] pursue, on the facts as well as in principle, a legitimate aim ‘in the public interest,’” and bear “a reasonable relationship of proportionality between the means employed and the aim sought to be realized.” This proportionality will not be found if the person concerned bears “an individual and excessive burden.” The Court considered that such “a measure must be both appropriate for achieving its aim and not disproportionate thereto.” The Court found relevant that non-nationals “will generally have played no part in the election or designation of its [of the measure] authors nor have been consulted on its adoption,” and observed that “there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals.” *Azurix*, *supra* note 188, para. 311; *see also* Case of James and Others v. The United Kingdom (Application No. 8793/79) (1986), [http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-57507#{"item id":\["001-57507"\]}](http://hudoc.echr.coe.int/sites/eng/pages/search.aspx?i=001-57507#{).

193. *Tecmed* decision, *supra* note 138, para. 127, 132.

194. *Id.*, para. 144.

195. *Compañía del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica* (ICSID Case No. ARB/96/1), Final Award (2000), [http://italaw.com/documents/santaelena\\_award.pdf](http://italaw.com/documents/santaelena_award.pdf).

from Costa Rica Republic due to an act of expropriation by the latter of a property known as “Santa Elena.”<sup>196</sup> The Tribunal held that

the purpose of protecting the environment for which the property was taken does not alter the legal character of the taking for which adequate compensation must be paid. The international source of the obligation to protect the environment makes no difference . . . [E]xpropriatory environmental measures—no matter how laudable and beneficial to society as a whole—are, in this respect, similar to any other expropriatory measures that a state may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the state’s obligation to pay compensation remains.<sup>197</sup>

This award paid no particular attention to environmental purposes for issuing the measure that was the basis for compensation. This environmental purpose did not alter the government’s obligation to compensate the investor. In other words, the international rules for investment protection took precedence over any rules of environmental protection. This may pose some dilemmas in which states may be prevented from interference, though justified, by effective environmental measures to fulfill its environmental obligations as this interference would be costly thereafter and needs to be financed.

The third factor that might be taken into account is the “duration of the measure”. The Tribunal, in *Azurix*, differentiated between a single measure and multiple measures by which it will depend on the duration of their cumulative effect, and this should be judged on a case-by-case basis as there is no mathematical formula to reach a mechanical result.<sup>198</sup> Accordingly, to be considered expropriatory, a measure should have a destructive and long-lasting effect on the economic value of the investment and its benefit to the investor.<sup>199</sup> Finally, the Tribunal found no expropriation in this case as:

the impact on the investment attributable to the Province’s actions was not to the extent required to find that, in the aggregate, these actions amounted to an expropriation; Azurix did not lose the attributes of ownership, at all times continued to control ABA and its ownership of 90% of the shares was unaffected. No doubt the management of ABA was affected by the Province’s actions, but not sufficiently for the Tribunal to find that Azurix’s investment was expropriated.<sup>200</sup>

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196. *Id.*, para. 3. It is worth-mentioning that both parties agreed that Claimant deserves compensation and Respondent concurred with Claimant that the core issue to be resolved was the amount of compensation owed to Claimant for the expropriation of the Property. *Id.*, para. 34.

197. *Id.*, para. 71-72.

198. *Id.*, para. 313.

199. UNCTAD, EXPROPRIATION, *supra* note 125, at 63.

200. *Azurix*, *supra* note 188, para. 322.

Moreover, in order to justify such exercise of the police power, “there must be ‘an average reciprocity of advantage’ as between the owner of the property restricted and the rest of the community.”<sup>201</sup> Furthermore, there should be a reasonable correlation between the harm suffered and the measure taken to prevent or eliminate this harm. Arbitral tribunals refer to this correlation by *proportionality*. The Tribunal, in *Tecmed v. Mexico*, held that “a regulatory measure could be an indirect expropriation by its characteristics when there was a *lack of proportionality* between the measure, the interest sought to be protected by such a measure and the protection of the investment, and as a result the economic value of the investment was destroyed.”<sup>202</sup> This standard appears to lie somewhere between the requirement that there should be a plausible basis for the measure and the requirement that the measure be the least restrictive necessary in order to meet the objectives of the Government.<sup>203</sup> In *Feldman v. Mexico*, the Tribunal noted that:

[G]overnments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this.<sup>204</sup>

However, the Tribunal in *Azinian v. Mexico*, required the government to intervene broadly in the investors’ expectations before awarding compensation.<sup>205</sup> In the 2000 *S.D. Myers*, an arbitrator wrote separately to emphasize that investors should expect regulatory change: “Expropriations without compensation tend to upset an owner’s reasonable expectations concerning what belongs to him, in law and in fairness. Regulation is something that owners ought reasonably to expect. It generally does not amount to an unfair surprise.”<sup>206</sup>

Although international tribunals have not agreed on a definitive test to compensating the indirect expropriation through regulatory

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201. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 422 (1922).

202. *Tecmed* decision, *supra* note 138, at 155.

203. Newcombe, *supra* note 150, at 430-31.

204. *Feldman*, *supra* note 168, para. 103.

205. Robert Azinian, Kenneth Davitian & Ellen Baca v. Mexico (ICSID Case No. ARB(AF)/97/2), para. 83 (1999), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC544\\_En&caseId=C156](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC544_En&caseId=C156).

206. *S.D. Myers, Inc. v. Canada*. Separate Opinion by Dr. Bryan Schwartz (on the Partial Award), para. 213 (2000), <http://www.italaw.com/sites/default/files/case-documents/ita0748.pdf>.

taking, they frequently refer to factors similar to those described by the U.S. Supreme Court.<sup>207</sup> In *Fireman's Fund v. Mexico*, the Tribunal found that:

[T]o distinguish between a compensable expropriation and a non-compensable regulation by a host [s]tate, the following factors (usually in combination) may be taken into account: whether the measure is within the recognized police powers of the host [s]tate; the (public) purpose and effect of the measure; whether the measure is discriminatory; the proportionality between the means employed and the aim sought to be realized; and the bona fide nature of the measure.<sup>208</sup>

Practically, under this test, the government is rarely held liable for regulatory action that leaves some economic value.<sup>209</sup>

Accordingly, the thin line between the non-compensable regulatory measure and the compensable expropriatory measure is basically the extent of interference in the utility of the investment property. While the compensable expropriatory measure deprives the investor of the total or substantive utility or control of the property, the non-compensable regulatory measure does not reach such degree of interference. Accordingly, permanent or long-term measures and the measures that have severe economic impact should be likely tantamount to expropriation. Furthermore, arbitrators may consider the following criteria in assessing the legitimacy of the measure: a) the economic impact of the measure, i.e., the degree of interference with the property right (including interference with the investor's reasonable investment-backed expectations); b) its purpose;<sup>210</sup> and c) the duration of the measure.<sup>211</sup>

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207. Under U.S. law, governmental taking of property for public use is prohibited without just compensation. In *Penn Cent. Transportation v. City of New York*, where the U.S. Supreme Court first recognized what has been called "regulatory takings." The court held that "[t]he economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations. . . . So, too, is the character of the governmental action. A "taking" may more readily be found when the interference with property can be characterized as a physical invasion by government . . . than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good." *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 124 (1978). Accordingly, in order for the regulatory measure to be tantamount to compensable expropriation, it has to be examined against the following three items: (1) the economic impact of the regulation on the claimant; (2) the extent of interference with the property owner's reasonable investment-backed expectations; and (3) the character of the governmental action. Subedi, *supra* note 76, at 130; *see also* Wagner, *supra* note 41, at 504-06 & 520.

208. *Fireman's Fund Ins. Co. v. Mexico*, (ICSID Case No. ARB(AF)/02/01), Award, para. 176 (2006), [http:// www.italaw.com/sites/default/files/case-documents/ita0331.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0331.pdf).

209. Wang, *supra* note 5, at 26; *see also* Wagner, *supra* note 41, at 509.

210. Tienhaara, *supra* note 131, at 8.

211. Wagner, *supra* note 41, at 525-26.

## INTERACTION BETWEEN INVESTMENT AND ENVIRONMENT

A conflict between environment and trade or investment does not always arise. Not all investments result in environmental harm, nor does environmental protection always affect investments. Of course, excessive environmental measures sometimes quash foreign investment and may lead to unfair competitive advantage for domestic business. On the other hand, over-regulation can create a vacuum of mutual mistrust and animosity.<sup>212</sup>

In this section, we will, first, discuss the general obligations of the states towards the environment, followed by explaining the state's capacity to issue environmental measures. Third, we will point out the overlap between investment protection and the environmental protection in which we discuss some investment treaties that deal with environmental concerns, the environmental impact on BITs language and interpretation, followed, finally, by explaining the possibility of compensating the environmental measures.

*State's Responsibility Towards The Environment*

Earlier, we explored the fundamental tenets of environmental law and the basic principles that govern the environmental protection.<sup>213</sup> Building on that discussion, states have certain obligations in preserving these environmental principles especially when the environment is threatened by harmful investment activities.

In encountering the potential risks that threaten the environment, governments have to determine the appropriate level of protection required to encounter these risks, which is a political decision in the foremost. This political decision might involve different elements to balance, including the valuable benefits that the risky investment provides for the country.<sup>214</sup> Governments, in response to the environmental risks, should enjoy the ability to enhance its environmental protection even if it includes the right to impose stricter standards.<sup>215</sup>

The protection of the environment is basically the responsibility of the states. IIAs provide states' governments with the right to regulate their environment. Sometimes, the parties to IIAs undertake not to lower the environmental standards in order to attract FDI.<sup>216</sup>

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212. Lilley, *supra* note 182, at 740-41.

213. See *supra* Part I.

214. Wagner, *supra* note 41, at 533-34.

215. *Id.*

216. UNCTAD, ENVIRONMENT, *supra* note 4, at 63.



States have a general obligation of satisfactory environment, which obliges their governments to take reasonable measures to prevent ecological degradation in addition to securing the ecologically sustainable development and use of natural resources.<sup>217</sup> Furthermore, governments should be cautious in dealing with the environmental measures in order not to lose such advantage of FDI.<sup>218</sup>

*The Capacity of States to Issue Environmental Measures*

Out of its sovereignty, each state has the legitimate right to regulate every aspect inside its territory including environmental issues. States may incorporate in the IIAs the so-called “*non-lowering of standards*” clause which aims at suppressing the intention of the host state to lower its environmental standards as an incentive to attract foreign investment.<sup>219</sup> Furthermore, states may provide exceptions to the general prohibition on the imposition of performance requirements in many IIAs.<sup>220</sup> NGOs often argue that investment treaties secure the export of highly polluting industries into the developing world, so, investment treaties should contain exemptions for host states to protect the environment. A few treaties on investment, such as NAFTA,<sup>221</sup> responded to this concern.<sup>222</sup> On the other hand, foreign investment might be jeopardized by environmental and resource mismanagement that reduce the availability of key natural resources for investment.<sup>223</sup>

States should protect the environment through legitimate regulations. In assessing the legitimacy of the regulation, a distinction should be drawn between risk assessment and risk management. Risk assessment refers to the legitimate goal of the government while risk management refers to the methods by which this regulation deals with the risk.<sup>224</sup> The regulation might be justified by a minority scientific opinion about the risks that are posed to the environment. However, the state should assess the availability of a reasonable and less restrictive alternative to address the risk.<sup>225</sup> On the other hand, governments, in some instances, eclectically chip away at the value of foreign invest-

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217. Juliane Kokott & Thomas Diehn, *Decision Regarding Communication 155/96*, in *International Decisions* (Bernard H. Oxman ed.) 96 AM. J. INT'L L. 937, 939 (2002).

218. Vadi, *supra* note 39, at 811.

219. Footer, *supra* note 8, at 45. Article 1114(2) of NAFTA recognizes that it is “inappropriate to encourage investment by relaxing domestic health, safety or environmental measures.”

220. Footer, *supra* note 8, at 42.

221. NAFTA art. 1114(2).

222. Newcombe, *supra* note 150, at 426-27.

223. For example, Zimbabwe's gold reserves are quickly depleting as a result of unfettered mining operations. See Martin, *supra* note 31, at 245-46.

224. KAHN ET AL., *supra* note 48, at 426.

225. *Id.* at 427.

ments in their country by using environmental regulation as a sort of “*trojan* horse” to benefit their domestic competitors, or appeasing anti-foreigner populist sentiments for political purposes.<sup>226</sup> This abuse of environmental regulations was manifested in the *Sakhalin* case.<sup>227</sup>

Foreign investors encroach the authority of the host state upon its domestic policymaking, including regulating the environment, when they challenge the environmental regulations. This is considered an indirect way of controlling the host state’s policy over the environment and resisting any attempt to strengthen its environmental protection measures.<sup>228</sup>

### *Environmental Implications of International Investments*

The mindset of the nineteenth century was to perceive the environment as a commodity for exploitation, and hence, it was not necessary to consider the impact of commercial activities on it. This approach has been directed to investment by focusing on the foreign investors’ interests at the expense of the host states’ interests in protecting the environment. This conceptualization needed to shift away to operate the investment in an ecologically sustainable environment.<sup>229</sup> The High Commissioner for Human Rights assured that investors’ rights should be utilized to serve wider goals such as sustainable human development, economic growth, stability, and protection of human rights.<sup>230</sup>

226. Marlles, *supra* note 171, at 332.

227. In 1994, Royal Dutch Shell company agreed with Russia to exploit a vast oil and natural gas field. The price of gas and oil steadily arose and the government asked Shell to renegotiate the initial agreement due to environmental concerns. Shell refused the renegotiation claiming that its performance was within the limits of Russian environmental laws. In return, the government revoked a key environmental permit for the project, and threatening to sue it criminally for the destruction of the forest. Moreover, Shell and its foreign partners agreed to give Gazprom, an energy company controlled by the Russian government, a 50% plus one share stake. As a result of the new agreement, “Mitsui’s share drops from 25% to 12.5%, and Mitsubishi’s from 20% to 10%,” while Shell’s share drops from 55% to 27.5%. The actions of the Russian government constituted regulatory expropriation. See, Marlles, *supra* note 171, at 333. In addition, there are numerous recent examples of environmental malpractice by foreign investors in host developing states. The disputes have involved allegations of environmental devastation, contamination of lands and rivers, ravaged rainforest, and damage to human health. Notable examples include operations of the Shell Oil Company in Nigeria, Freeport and Rio Tinto in Indonesia, ChevronTexaco Corporation in Ecuador, Broken Hill Proprietary Company (“BHP”) in Ok Tedi, Papua New Guinea, and Union Carbide in Bhopal, India. For more details see Miles, *supra* note 78, at 27.

228. Miles, *supra* note 78, at 41.

229. *Id.* at 24.

230. Human Rights, Trade and Investment. Report of the UN High Commissioner for Human Rights, E/CN.4/Sub.2/2003/9 (2003), <http://www.ifc.org/wps/wcm/connect/9feb5b00488555eab8c4fa6a6515bb18/Stabilization%2BPaper.pdf?MOD=AJPERES>.

Traditionally, national laws were the legal tools for addressing environmental concerns, along with codes of conduct adopted by corporations and industry groups. More recently, IIAs have focused on environmental concerns.<sup>231</sup> IIAs determine the balance between investor protection and environmental protection, which became one of the top priorities for societies and an important element of treaty negotiations.<sup>232</sup>

States are expected to take responsible measures to regulate the environment while facilitating the foreign investment. However, they should apply environmental regulations consistently to promote fair competition between domestic and foreign investors.<sup>233</sup> Inconsistent application of environmental standards may result in a disadvantage to non-complying competitors who save the costs of compliance with these standards.<sup>234</sup>

IIAs often refer to foreign investors' obligations towards the environment and the extent to which the host state may interfere with the foreign investment based on environmental justifications. We will examine this aspect of IIAs, and consider both treaties of NAFTA and CAFTA in relation to environmental implications of the foreign investment. Then, we present the environmental impact upon the IIAs languages and interpretation. Finally, we discuss the compensability of environmental measures.

#### IIAs: Bilateral and Multilateral Investment Treaties

IIAs include bilateral ("BITs") and multilateral investment treaties ("MITs"). BIT is considered the most important legal instrument in protecting foreign investment.<sup>235</sup> There is a growing number of BITs that govern foreign investments.<sup>236</sup> Since 1960, BITs were created to provide a stable international legal framework for the regulation of direct foreign investment.<sup>237</sup> Treaty provisions do not often provide precise definitions of the standards of protection, potentially creating

231. UNCTAD, ENVIRONMENT, *supra* note 4, at 72.

232. A survey on the IIAs that contain environmental language is available at <http://www.oecd.org/investment/internationalinvestmentagreements/46905672.pdf> at 30, 33.

233. Martin, *supra* note 31, at 216-18.

234. *Id.*

235. Since a very early time, there existed treaties to promote and protect trade taking the form of "friendship, commerce and navigation" ("FCN"). See Sornarajah, *supra* note 34, at 180.

236. In 1990, there were 435 bilateral investment agreements (BITs). By the end of the millennium the number of BITs increased to 2,600 treaties. See Sornarajah, *supra* note 34, at 172; 2012 US MODEL BILATERAL INVESTMENT TREATY, <http://www.state.gov/documents/organization/188371.pdf> (last visited at March 20, 2016).

237. David R. Adair, *Investors' Rights: The Evolutionary Process of Investment Treaties*, 6 TULSA J. COMP. & INT'L L. 195, 197 (1999).

a tension between these standards and the regulatory measures adopted by states that interfere with foreign investments.<sup>238</sup> BITs are introduced as a “remedial documents” to ensure that foreign investments are subject to the rule of law.<sup>239</sup> They are made on an ad hoc basis to be negotiated for the parties’ mutual interests and serve as a solution in the absence of consensus to multilateral norms.<sup>240</sup> BITs provide the parties with an opportunity to observe unified investment norms in each other’s territory.<sup>241</sup>

## NAFTA

The North American Free Trade Agreement (“NAFTA”) is an attempt to reconcile the conflict between the investment and the environment by incorporating self-standing provisions for protecting both. It addresses explicitly the environmental effects of the free trade between its member states.<sup>242</sup> Furthermore, NAFTA includes certain provisions approving environmental regulation that do not appear in other investment agreements.<sup>243</sup>

In 1993, in order for NAFTA parties to recognize the interrelationship of their environment,<sup>244</sup> they concluded a parallel agreement i.e., the North American Agreement on Environmental Cooperation (“NAAEC”) to protect and enhance the environment in their territories.<sup>245</sup> NAAEC was created primarily to support the environmental goals and objectives of NAFTA.<sup>246</sup> Both agreements represent important precedents for reconciling the tension between economic development and environmental protection. They were hailed as landmarks in providing for environmental protection within a free-

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238. Vadi, *supra* note 39, at 824.

239. Kenneth J. Vandavelde, *BILATERAL INVESTMENT TREATIES HISTORY, POLICY, AND INTERPRETATION*, 2 (Oxford University Press, 2010).

240. Sornarajah, *supra* note 34, at 183.

241. *Id.* at 184.

242. HUNTER, ET AL., *supra* note 2, at 1308. Article 1114(2) of NAFTA entitled (Environmental Measures) reads “The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures”. North American Free Trade Agreement, U.S.-Can.-Mex., art. 1114(2), Dec. 17, 1992, 32 I.L.M. 289 (1993), *available at* <https://www.nafta-sec-alena.org/Home/Legal-Texts/North-American-Free-TradeAgreement#A1114>.

243. Gantz, *supra* note 128, at 10651.

244. Francisco S. Nogales, *The Nafta Environmental Framework, Chapter 11 Investment Provisions, and the Environment*, 8 ANN. SURV. INT’L & COMP. L. 97, 104 (2002).

245. North American Agreement On Environmental Cooperation, U.S. – Can. – Mex. (1993), <http://www.cec.org/sites/default/files/naaec.pdf> [hereinafter NAAEC].

246. *Id.*, art. 1(d) (“Objectives”).

trade agreement.<sup>247</sup> They provide a special status for environmental protection.<sup>248</sup>

Due to their impact over all areas of law, including environmental law, the trade agreements are given a “quasi-constitutional” legal status which affect governments to act in certain ways and to withdraw or amend specific measures.<sup>249</sup> The impact of trade law on the environment led to the creation of the Commission for Environmental Cooperation (“CEC”)<sup>250</sup> under the NAAEC.<sup>251</sup> CEC was established to address the regional environmental concerns between the parties,<sup>252</sup> and promote the enforcement of environmental law. CEC is administered by a council, which is responsible for further consultation and cooperation among the parties to avoid the environment-related trade disputes and develop recommendation regarding environmental matters that are related to economic development.<sup>253</sup> The only problem with CEC is that it is not an enforcement agency.<sup>254</sup> Nevertheless, CEC has the potential to achieve significant environmental results over the long run.<sup>255</sup>

Chapter 11 of NAFTA deals with the investment established in each contracting party (USA, Mexico, and Canada) by an investor from another contracting party. It raises fundamental concerns about the tension between investment protection and trans-border natural resources<sup>256</sup> and whether the process of resolving this tension is adequate or there are more appropriate processes to be used.<sup>257</sup> Chapter 11 was created as a security for investors, which was widely viewed as

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247. Lilley, *supra* note 182, at 727.

248. Julia Ferguson, *California's Mtbe Contaminated Water: An Illustration of the Need for an Environmental Interpretive Note on Article 1110 of Nafta*, 11 COLO. J. INT'L ENVTL. L. & POL'Y 499, 501 (2000).

249. Howard Mann, *Nafta and the Environment: Lessons for the Future*, 13 TUL. ENVTL. L.J. 387, 391-92 (2000).

250. NAAEC, *supra* note 245, art. 8. “The Commission  
The Parties hereby establish the Commission for Environmental Cooperation.  
The Commission shall comprise a Council, a Secretariat and a Joint Public Advisory Committee.”

251. Mann, *supra* note 249, at 394.

252. NAAEC, *supra* note 245, art. 10(f).

253. *Id.*, art. 10(l).

254. Nogales, *supra* note 244, at 106.

255. Mann, *supra* note 249, at 394 (“NAFTA negotiations also led to the creation of two Mexico-United States border institutions, the North American Development Bank (NADBank) and the Border Environmental Cooperation Commission (BECC) . . . Nevertheless, the mandate of these two bodies does not extend to the relationship between trade law and environmental concerns.”).

256. Paul Stanton Kibel & Jonathan R. Schutz, *RIO Grande Designs: Texans' NAFTA Water Claim Against Mexico*, 25 BERKELEY J. INT'L L. 228, 242-43 (2007).

257. *Id.* at 266.

a critical factor in the rapid expansion of foreign direct investment.<sup>258</sup> Investment and foreign investors are protected under NAFTA from certain kinds of governmental measures. The meaning of measure is very broad to include all legislations adopted by the host state or any of its organs, whether laws, regulations, or administrative decisions, having an impact on investment. Simply, investors are protected from nearly all forms of governmental actions.<sup>259</sup>

NAFTA environmental provisions are to be applied properly by its parties in a way that permits each party to set its own levels of environmental protection and enforce them without lowering their environmental standards (race to the bottom scenario) nor fabricating environmental pretext (race to the top scenario).<sup>260</sup> Article 1105 of NAFTA refers to the minimum standards of treatment to investors, which should be in accordance with international law.<sup>261</sup> The phrase “international law” includes customary international law, international environmental principles, or international environmental treaties. Investors can claim the unfair treatment<sup>262</sup> or expropriation<sup>263</sup> based on environmental measures.

NAFTA allows investors to proceed directly against the government of the host state through international arbitration. The major arbitration system is administered by the World Bank by the International Center for the Settlement of Investor Disputes (“ICSID”).<sup>264</sup>

However, Civil Society Organizations (“CSOs”) considered NAAEC a weak and ineffectual instrument<sup>265</sup> that failed to address the environmental concerns. Due to the massive number of cases initiated under NAFTA, CSOs suggest to review NAFTA system.<sup>266</sup> In addition, the language of NAFTA is unclear in relation to the conflict between environmental concerns and investor’s rights and which one should prevail.<sup>267</sup> Nonetheless, some authors argue that no tribunal created under NAFTA Chapter 11 has relied extensively on the environmental provisions.<sup>268</sup> Furthermore, some NAFTA scholars suggest

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258. Mann, *supra* note 249, at 402-03.

259. Nogales, *supra* note 244, at 109.

260. Lilley, *supra* note 182, at 746; Ferguson, *supra* note 248, at 505.

261. NAFTA art. 1105, <http://www.sice.oas.org/trade/nafta/chap-111.asp>.

262. Todd Weiler, *A First Look at the Interim Merits Award in S.D. Myers, Inc. v. Canada: It Is Possible to Balance Legitimate Environmental Concerns with Investment Protection*, 24 HASTINGS INT’L & COMP. L. REV. 173, 184-85 (2001).

263. Kahn, *supra* note 31, at 424.

264. *See infra* at Part IV(A).

265. Footer, *supra* note 8, at 38-39.

266. Mann, *supra* note 249, at 388-89.

267. The issue of interpretation and language of BITs is discussed *infra* at Part III(C)(2).

268. Gantz, *supra* note 128, at 10647.

that future tribunals may take into consideration the following: (a) the claimant's standing; (b) the reflection of the environmental regulation of thorough risk assessment, based on scientific data and its consistency with national law and procedural due process; (c) the discriminatory nature of the environmental regulation whether *de jure* or *de facto* discrimination against foreign investors; and (d) the degree of substantial interference of the measure with investor's property.<sup>269</sup>

### CAFTA

The Central America Free Trade Agreement (CAFTA) is an expansion of NAFTA to five Central American nations (Guatemala, El Salvador, Honduras, Costa Rica and Nicaragua), and the Dominican Republic. CAFTA has been billed as a free trade agreement that is "greener" than NAFTA. CAFTA's supporters argue that its environmental provisions would increase the level of economic activities while avoiding environmental degradation.<sup>270</sup> However, CAFTA contains different procedural and substantive provisions that may affect the outcome of environment-related disputes.<sup>271</sup> Thus far, there have been three publicized investor-state cases under the auspices of CAFTA.<sup>272</sup> Unlike NAEEC, CAFTA has omitted an advisory body of environmental experts to review environmental matters.<sup>273</sup>

CAFTA is considered the "fetus of NAFTA,"<sup>274</sup> which has exacerbated the "race to the bottom"<sup>275</sup> in environmental standards.<sup>276</sup> Many provisions of CAFTA are mirrored, in language and meaning, from NAFTA's Chapter 11.<sup>277</sup> Despite the similarities between the provisions of CAFTA and NAFTA, there are still some differences between them. Article 10.7 of CAFTA defines "expropriation" by referring to Annexes 10—B and 10—C of CAFTA's Investment Chapter, whereas Article 1110 of NAFTA contains no such reference

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269. Gantz, *supra* note 89, at 740-41.

270. Wang, *supra* note 5, at 255.

271. *Id.* at 254.

272. See *R.R. Dev. Corp. v. Guat.*; *Pac.Rim Cayman, L.L.C. v. Republic of El Sal.*; *Commerce Grp. Corp. v. Republic of El Sal.*, <http://www.citizen.org/Page.aspx?pid=1046#cases>.

273. Wang, *supra* note 5, at 274.

274. Stephen J. Byrnes, *Balancing Investor Rights and Environmental Protection in Investor-State Dispute Settlement Under CAFTA: Lessons from the NAFTA Legitimacy Crisis*, 8 U.C. DAVIS BUS. L.J. 103, 18 (2007).

275. This is a socioeconomic concept that reflects deregulation of business environment in order to attract or retain economic activity with lower environmental protection.

276. Central America Free Trade Agreement (CAFTA), PUBLIC CITIZEN, <http://www.citizen.org/Page.aspx?pid=1046> (last visited at March 20, 2015).

277. For example, defining what actions by participating countries constitute "national treatment," "most favored nation treatment," and measures equivalent to prohibited "expropriations."

addenda.<sup>278</sup> This interpretative addenda would ease the tribunals' mission in interpreting the term "expropriation" in consistent manner. Due to the absence of such interpretative addenda in NAFTA, tribunals, in NAFTA disputes, would have the discretion in interpreting the term expropriation, which would lead to inconsistency between arbitral tribunals in defining and interpreting expropriation under NAFTA.<sup>279</sup>

The second difference between both treaties is the degree of transparency in the arbitral proceedings.<sup>280</sup> There is a major reform introduced by CAFTA for the openness of the arbitral proceedings and providing greater transparency<sup>281</sup> unlike the secretive nature of NAFTA's disputes, which denies important groups, such as environmental NGOs, from the opportunity to present their views to the tribunals.<sup>282</sup> CAFTA authorizes the arbitral tribunals the discretion to accept the *amicus curiae* submissions.<sup>283</sup>

In addition, CAFTA has introduced an appellate review body for the purpose of "prompt review and, where warranted, correction of final administrative actions regarding matters covered by this Agreement."<sup>284</sup> This appellate body helps in scrutinizing the arbitral awards, correcting its flaws, and providing a greater uniformity in interpreting CAFTA's provisions.<sup>285</sup> It would protect the environmental legislation from frivolous challenges as it will review the claims decided by the tribunals, including the legitimacy of the environmental measures. This body will limit the future challenges of environmental regulations to the cases where there is sufficient harm only as a matter of law, which promote the consistency and efficiency of the investor-state dispute settlement mechanism.<sup>286</sup>

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278. Annex 10—B expresses the signatory countries' commitment to using customary international law to interpret the standards contained in Chapter 10, including Article 10.7. Annex 10—C lays out interpretive rules for how arbitral panels are to determine what actions qualify as "indirect expropriations. USTR Office, Central America Free Trade Agreement, June 1, 2004, art. 10.7 and Annex—B, [http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset\\_upload\\_file328\\_4718.pdf](http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf) (last visited at March 20, 2016); Byrnes, *supra* note 274, at 21.

279. Byrnes, *supra* note 274, at 21.

280. *Id.* at 22.

281. *Id.* at 34; *See also infra* at Part IV(B).

282. Byrnes, *supra* note 274, at 34.

283. CAFTA, *supra* note 278, at art. 10.20(3).

284. *Id.*, art. 18.5. This regime will be discussed *infra* in Part VII "Proposed Regimes."

285. Byrnes, *supra* note 274, at 45.

286. *Id.* at 46.



### Environmental Impact on BITs Language and Interpretation

Environmental concerns have their implications upon the investment treaties whether in relation to the language used to refer to these concerns in the treaties or the tools to be used in interpreting the environmental-related treaty provisions. We discuss the languages used in the treaties that refer to the environmental concerns and then analyze the interpretative tools used in interpreting these provisions.

#### Environmental Impact on BITs Language

Generally, BITs refer to the environmental concerns in generic terms, primarily in the preamble or general provisions, by assuring the need to protect the environment and sometimes linked to the principle of sustainable development. Furthermore, the methods of referring to environmental concerns vary in BITs. First, the parties may prefer to ignore the environmental issues. Second, environmental issues may be addressed in general or hortatory provisions. Third, they may be addressed in specific clauses that affirm the host state's powers to protect environment, including the pledge not to lower environmental standards to attract investment.<sup>287</sup> The references are often mentioned among other concerns in hortatory language, for example as one feature to environmental concerns, among others, of sustainable development, or as a general exception, or as an explicit recognition that parties shall not relax environmental standards to attract investment; and finally, as an element of corporate social responsibility standards.<sup>288</sup>

Results from the 2010 Organization for Economic Co-operation and Development ("OECD") survey showed that references to environmental concerns appear only in a fraction of investment agree-

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287. UNCTAD, *ENVIRONMENT*, *supra* note 4, at 36-41. An example of the general reference to environmental concerns was the Fourth ACP-EEC Convention (Lom. . . IV), under article 77, actual mention is made of investment in connection with environmental concerns. *Id.* at 15-16; an example of particular reference to the environment is found under Article 32 of Contonou Agreement entitled "Environment and natural resources", provides for cooperation in relation to the protection of specified areas of the environment. In stronger language, the Convention on Environmental Impact Assessment in a Trans-boundary Context, signed by over 25 European countries, Canada and the United States, provides, in article 2(1), that: "1. The Parties shall, either individually or jointly, take all appropriate and effective measures to prevent, reduce and control significant adverse trans-boundary environmental impact from proposed activities." *Id.* at 17.

288. *Trade and Development Board*, *supra* note 46, at 9 n. g. The preamble of the United States Model Bilateral Investment Treaty (2012) reads "Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment . . . ."

ments, but are becoming much more common in new treaties.<sup>289</sup> Environmental concerns became a constant feature in investment treaties since the inception of NAFTA.<sup>290</sup> There are around 66 IIAs and 2 model BITs that contain preamble clauses on environmental concerns.<sup>291</sup> On the other hand, such references may take the form of assertions that the agreements' provisions will not prevent the parties from regulating environmental issues or, alternatively, affirming the state's right to regulate environmental matters in compliance with international environmental agreements, with the undertaking not to lower environmental standards for attracting FDI.<sup>292</sup> Furthermore, there are some environmental agreements that contain direct reference to FDI.<sup>293</sup>

Some recent investment treaties contain substantive provisions relating to health and the environment. For instance, many recent U.S. BITs provide that "[n]othing in this Treaty shall be construed to prevent a Party from adopting, maintaining[,] or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns." Such clauses are called "non-precluded measures clauses" ("NPM clauses"), which protect certain types of state conduct from liability under the substantive standards of protection.<sup>294</sup>

Some authors have criticized not only the hortatory language of the environmental reference in investment treaties with unenforceable feature, up to no more than consultations among parties,<sup>295</sup> but also the vague clauses that require consistency of the environmental measures with treaty provisions.<sup>296</sup> This poor drafting of investment treaties undermines the power of the host state to adopt and implement environmental and sustainable development policies.<sup>297</sup>

289. Julianne J. Marley, *The Environmental Endangerment Finding in International Investment Disputes*, 46 N.Y.U. J. INT'L L. & POL. 1003, 1015-16 (2014).

290. NAFTA, art. 1114(2), <https://www.nafta-sec-alena.org/Home/Legal-Texts/North-American-Free-Trade-Agreement>.

291. OECD, *Harnessing Freedom of Investment for Green Growth*, 37, <http://www.oecd.org/investment/internationalinvestmentagreements/46905672.pdf> (last visited March 20, 2016).

292. UNCTAD, *ENVIRONMENT*, *supra* note 4, at 3-4.

293. *Id.* at 14.

294. Rahim Moloo, Justin Jacinto, *Environmental and Health Regulation: Assessing Liability Under Investment Treaties*, 29 BERKELEY J. INT'L L. 1, 8-9 (2011).

295. For instance, the breach of NAFTA Article 1114(1) would give rise to no more than consultations among parties.

296. Vadi, *supra* note 39, at 824.

297. *Id.* at 870.

These arguments support the concept that environmental concerns should be explicitly addressed in IIAs. Since addressing the environmental concerns in a general or hortatory provisions might give the parties the feeling that environmental concerns resemble sonorous speeches that people only listen to but they are not convinced nor obliged by. On the other hand, incorporating specific environmental standards in BITs may lead to many problems as whether these environmental standards are exhaustive or non-exhaustive and they would be difficult to be amended. Accordingly, it has been suggested that environmental concerns should be addressed directly in a clear cut provisions giving the state the power to protect its environment without harming the investor's property in light of the agreed upon standards to be negotiated between the state and the investors in a transparent way. These provisions should reflect the importance of environmental concerns on the international arena that escalate the states' obligations of preserving its environment to the level of *jus cogens* norms.<sup>298</sup> These provisions would acquire this nature from their purpose i.e., to preserve the environment, which would affect human's health and life and parties cannot agree to any provisions that adversely affect human's health and life.<sup>299</sup>

MNEs must either become environmentally responsible, or face the risk of financial loss as the global environment declines.<sup>300</sup> At the end, in incorporating environmental standards in BITs, there should be a balancing of at least two sets of arguments. First, the prescription of certain standards could in some circumstances amount to a form of disguised protectionism. Second, the need to promote certain environmental standards may outweigh certain negative impacts on investment growth and possibly, on intellectual property rights.<sup>301</sup>

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298. *Jus cogens* is defined by the Vienna Convention on the Law of Treaties (VCLT) as "a norm accepted and recognized by the international community of states as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character."

299. "... *Jus cogens* has no ascertainable basis. Although there is no simple criterion by which to identify a general rule of international law as having the character of *jus cogens*, the concept of *jus cogens* is positive law . . . Given the legal uncertainty surrounding the term, it is up to international adjudicating bodies to decipher the complex tapestry of international law in determining its meaning." Vadi, *supra* note 39, at 857-58.

300. Martin, *supra* note 31, at 246-47.

301. UNCTAD, ENVIRONMENT, *supra* note 4, at 72.

## Environmental Impact on BITs Interpretation

The Vienna Convention on the Law of Treaties is the prevailing instrument in interpreting investment treaties.<sup>302</sup> Treaty provisions should be given an ordinary meaning, not a technical one and should be interpreted in light of the objects of the treaty itself which might be stated clearly, whether in the preamble of the treaty or any other provisions, or discerned from the whole provisions. Article 31(1) strikes a balance between the text of a treaty and its context, object, and purpose to appear as complementary to avoid the notorious battles between the language and purpose of a given text.<sup>303</sup>

These interpretation rules are considered a configuration of customary international law rules of interpretation.<sup>304</sup> Nevertheless “it is difficult to find a tribunal which formally and properly applied the Vienna Rules step by step.”<sup>305</sup> However, the tribunal in *Metalclad*, applying Article 102(2) of NAFTA,<sup>306</sup> interpreted the Article 1105(1) guarantee as a minimum standard of treatment under international law in terms of Articles 26 and 27 of the Vienna Convention of the Law of Treaties<sup>307</sup> and indicated that domestic legal regimes cannot be relied upon to escape honoring international obligations.<sup>308</sup>

Arbitral tribunals have rarely addressed the non-investment law principles, as they are rarely invoked by foreign investors in invest-

302. Article 31(1) of the Vienna Convention provides that “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”

303. Gary Born, *Should Investment Treaties Have Their Own Rules of Interpretation?*, Kluwer Arbitration Blog (2015).

304. Arbitral Award of 31 July 1989 case, the ICJ observed that the principles of treaty interpretation “are reflected in Articles 31 and 32 of the Vienna Convention on the Law of Treaties, which may in many respects be considered as a codification of existing customary international law on the point” (Judgment of November 12, 1991, ICJ Reports 53 (1991), at 70).

305. IN INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY: ESSAYS IN HONOUR OF CHRISTOPH SCHREUER 730, 746 (Christina Binder et al. eds., Oxford University Press 2009). This view was confirmed in a dissenting opinion of Jan Paulsson in *Hrvatska Elektroprivreda d.d. v. Slovenia* (ICSID Case No. ARB/05/24). See Dissenting Opinion to the Decision on the Treaty Interpretation Issue of June 12, 2009, 44), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1091\\_En&caseId=C69](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1091_En&caseId=C69).

306. Article 1.2(2) entitled objectives and reads “The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.” NAFTA art. 1.2(2).

307. Article 26 of the Vienna Convention reads “Every treaty in force is binding upon the parties to it and must be performed by them in good faith,” and Article 27 reads “A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. This rule is without prejudice to article 46.” <https://treaties.un.org/doc/Publication/UNTS/Volume%201155/volume-1155-I-18232-English.pdf> (last visited at March 20, 2016).

308. Marc Andrew Munro, *Expropriating Expropriation Law: The Implications of the Metalclad Decision on Canadian Expropriation Law and Environmental Land-Use Regulation*, 5 ASER REV. INT’L BUS. & TRADE L. 75, 106-07 (2005).

ment arbitrations. Even when the investors invoke such norms, the tribunals do not often address them whether by dismissing issues on procedural grounds or failing to deal with the substantive arguments at all.<sup>309</sup> Definitely, there are some concerns about investment tribunals' attitude towards the area of state environmental regulation. Out of such concerns, some states have modified their model treaty language for new instruments, concluding subsequent interpretive agreements to the existing instruments, or withdrawing in part or entirely from the investor-state arbitration system.<sup>310</sup>

Tribunals have to pay more attention to the legal dimensions of non-investment issues which cannot be neglected in favor of purely economic considerations.<sup>311</sup> Interpretation rules should be consistent with the legitimacy of international legal order, which is a challenge, on and of itself, because it depends on the ability to meld together the different parts of the international legal order and its development, including international economic law and international environmental law.<sup>312</sup> However, arbitral tribunals should not use interpretation rules as a way of favoring the investor interests or other non-investment interests. Interpretation should be in light of the whole context and purpose of the treaty itself regardless of whom it serves as affirmed in *Azurix* case.<sup>313</sup>

#### Should Environmental Measures Be Compensated?

Earlier, we discussed the difference between regulatory taking measures that are non-compensable and the expropriatory measures that require compensation.<sup>314</sup> Now, we build on this distinction in addressing the environmental measures and whether it should result in compensation to a private investor.

Generally, there are three primary rationales for compensating foreign investors. First, states should provide a remedy for the investor when it acquires the latter's property directly or indirectly.<sup>315</sup> Second, state measures deprive the investor of his investment property because they are necessary for protecting an essential public interest.

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309. Vadi, *supra* note 39, at 866-67.

310. Marley, *supra* note 289, at 1015-16.

311. Vadi, *supra* note 39, at 868-69.

312. Philippe Sands, *Searching for Balance: Concluding Remarks*, 11 N.Y.U. ENVTL. L.J. 198, 203 (2002).

313. *Azurix* decision, *supra* note 186, para. 307.

314. *See supra* Part II(E)(3).

315. This protects against unjust enrichment and ensures that where the public benefit is obtained the burden of obtaining that benefit is borne by the general public.

Third, expropriation protection preserves states' contractual commitments and protects investors' legitimate expectations.<sup>316</sup>

Environmental provisions that give special consideration to environmental regulations would be most appropriate in case where the environmental regulation is foreseeable and the investor is deprived of only a portion of his property, or beneficial use of it and there is no substantial interference with its business or profits.<sup>317</sup>

In *Metalclad Corporation v. United Mexican States*,<sup>318</sup> Metalclad, an incorporated U.S. company,<sup>319</sup> purchased COTERIN, a Mexican company, for acquisition, development and operation of the latter's hazardous waste transfer station and landfill in Guadalcázar, a Mexican Municipality.<sup>320</sup> COTERIN was granted a "federal permit" to construct the hazardous waste landfill by the National Ecological Institute ("INE").<sup>321</sup> Metalclad possessed all necessary permits for the landfill except the federal permit for operating the landfill.<sup>322</sup> Metalclad resumed the construction of the landfill due to receiving an eighteen-month extension of the federal permit.<sup>323</sup> Subsequently, the Municipality ordered the cessation of all building activities in the landfill due to the absence of a municipal construction permit.<sup>324</sup> In 1995, the INE granted Metalclad an additional federal permit for constructing the final disposition cell for the landfill.<sup>325</sup> Metalclad was required to submit an action plan to correct the deficiencies that were detected by the environmental audit that checked the project's compliance with the laws and regulations.<sup>326</sup> Eventually, Metalclad's application for the municipal construction permit was denied,<sup>327</sup> without Metalclad being invited to discuss the application. Metalclad's request for reconsideration of the permit denial was rejected.<sup>328</sup> Metalclad initiated arbitration against Mexico alleging that Mexico's local government interfered with its development and operation of a hazardous waste

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316. KAHN ET AL., *supra* note 48, at 447.

317. Gantz, *supra* note 89, at 750.

318. *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1) (2000), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542\\_En&caseId=C155](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542_En&caseId=C155).

319. *Id.* It owns wholly Eco-Metalclad Corporation. Eco-Metalclad owns 100% of shares of ECONSAR.

320. *Metalclad* decision, *supra* note 318, para. 2.

321. *Id.* para. 28, 29.

322. *Id.* para. 33.

323. *Id.* para. 38.

324. *Id.* para. 40.

325. *Id.* para. 43.

326. *Metalclad* decision, *supra* note 318, para. 48.

327. *Id.* para. 50.

328. *Id.* para. 54.

landfill, thereby violating Chapter 11 of NAFTA; Article 1105 (FET), Article 1110 (Expropriation).<sup>329</sup> In deciding the expropriation claim, the tribunal held that:

expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host state, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State . . . these measures [denial of permit without basis, municipality acting outside its authority, subsequent judicial and administrative actions, regarding *Convenio*], taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation.<sup>330</sup>

This broad definition of expropriation<sup>331</sup> led the tribunal to consider that Mexico, by its *ultra vires* unlawful actions of the municipality, undermined Metalclad's right to operate the landfill.<sup>332</sup> This reasoning was criticized as being an "expansive reading of indirect expropriation."<sup>333</sup> On another note, the tribunal declined to consider the motive or intent for adopting the Ecological Decree (the environmental measure) and considered its implementation would, in itself, constitute an act tantamount to expropriation.<sup>334</sup> The award is of essence due to the broad interpretation it gave to expropriation which includes "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."<sup>335</sup>

It is apparent that in *Metalclad*, the tribunal neglected the policy rationale for issuing the measure and concerned only about the regulatory interference with the private property rights of the investors, which necessitates compensation on the basis that the state parties

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329. *Id.* para. 1.

330. *Id.* para. 103-104, 107.

331. Justice Tysoe noted that the tribunal gave an "extremely broad definition" of expropriation and is "sufficient to include a legitimate rezoning of property by a municipality or other zoning authority." See Munro, *supra* note 308, at 111-12.

332. Munro, *supra* note 308, at 108-09.

333. Wang, *supra* note 5, at 269.

334. *Metalclad* decision, *supra* note 319, para. 111.

335. Sands, *supra* note 312, at 198-99.

agreed on higher standard of property protection more than those afforded in customary international law.<sup>336</sup>

Generally, wherever there might be inconsistency between investment and non-investment obligations, it is understood that the host state may adopt the most consistent actions with its international investment obligations to generate minimum harm to foreign investors.<sup>337</sup> As discussed earlier, certain types of measures that may affect foreign property will be considered an expropriation and require compensation even though the owner retains the formal title as long as they interfere with the utility of the investment.<sup>338</sup>

Although some authors view environmental regulations as tantamount to taking property,<sup>339</sup> others view them as non-compensable takings because they are essential to the efficient functioning of the state.<sup>340</sup>

However, compensating the foreign investors due to environmental measures might collide with the “polluter pays” principle.<sup>341</sup> When a state interferes to protect the environment from the harmful activity of the investor, it protects the society as a whole against an individual’s harmful conduct. Accordingly, when the state pays compensation to the investor due to the impact of the measure upon his investment, it pays this compensation in the name of the society as a whole<sup>342</sup> and “the public at large” bears the burden of these legislations – is directly at odds with the polluter pays principle.<sup>343</sup> In other words, it is argued if the community, represented by the government, pays the polluters to stop or modify their behavior, it means that polluters own the environment and use it with impunity.<sup>344</sup> For these rea-

336. Munro, *supra* note 308, at 84-85.

337. Moshe Hirsch, *Interactions between Investment and Non-investment Obligations*, in *THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW*, at 166 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008).

338. The surrounding circumstances- such as epidemic infections or diseases- may prompt the authority to confiscate the property by destroying. For example, in 1894 the Brazilian authorities destroyed lots of watermelons due to an outbreak of cholera. This measure was justified in the circumstances and no compensation was paid to watermelon producers. See KAHN ET AL., *supra* note 48, at 424-25.

339. Boyle, *supra* note 18, at 141.

340. Wagner, *supra* note 41, at 517-18.

341. This principle was discussed *supra*, at Part I(B)(3).

342. The U.S. Supreme Court explained that the “determination that governmental action constitutes a taking, is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest,” and we recognized that this question “necessarily requires a weighing of private and public interests.” *Keystone Bituminous Coal Ass’n v. DeBenedictis*, 480 U.S. 470, 492, 107 S. Ct. 1232, 1246, 94 L. Ed. 2d 472 (1987).

343. Wagner, *supra* note 41, at 471.

344. Munro, *supra* note 308, at 96-97.



sons, some authors criticized the *Metalclad* decision because it arguably transformed the well-established environmental principle of “polluter pays” into “pay the polluter.”<sup>345</sup> Requiring compensation for the economic impact of environmental regulations conflicts with the treaty provisions that obligate states to preserve the sound environmental framework for the investment, which means it will be costly for governments to enforce or strengthen existing environmental measures or to adopt new ones.<sup>346</sup>

According to one author, the right of the state to adopt appropriate regulatory measures is undermined if these measures are treated as tantamount to expropriation.<sup>347</sup> In other words, environmental regulations should be considered legitimate regulations that do not normally give rise to an obligation to compensate in analogous to other governmental regulations.<sup>348</sup> Environmental regulations are of the same level of importance to be legitimate as those governmental regulations. This approach is consistent with the polluter pays principle to make governments free to implement environmental regulations without having to pay to do so.<sup>349</sup>

Generally, arbitral tribunals look at the investment duration, the effect of expropriatory measure, the substantial deprivation of the investor, whether the investor remains control over the investment assets, and investor’s legitimate expectations. Practically, each tribunal tries to strike a balance between the conflicting interests, investor’s rights of protection, and the host state’s right to protect the public interests i.e., environmental protection.<sup>350</sup>

A number of approaches were introduced in addressing the environmental measures to be considered lawful regulatory takings. First, to follow the reasoning of *Metalclad* i.e., adopting a broad definition of expropriation, by which states would be forced to take into their account the economic consequences of their actions. Second, considering expropriation rules as an insurance scheme, when the investment fails, the state becomes an insurer of last resort. Third, the rules

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345. *Id.*

346. Wagner, *supra* note 41, at 529.

347. Subedi, *supra* note 76, at 127.

348. Such as tax regulations, regulations governing the transfer and exchange of currency, and licensing fees for the production of alcoholic beverages. See Wagner, *supra* note 41, at 528.

349. *Id.* at 528-29.

350. Footer, *supra* note 8, at 41-42. The Tribunal in *Glamis* noted “the tension . . . between private rights in property and the need of the State to regulate the use of property.” <http://italaw.com/sites/default/files/case-documents/ita0378.pdf>.

should promote the fairness relationship between a foreign investor and the state.<sup>351</sup>

Furthermore, in measuring the legitimacy of the measure, caution should be addressed to the scientific evidence as it might undermine the precautionary principle that “science does not always provide the information or insights necessary to take protective action effectively or in a timely manner, and that undesirable and potentially irreversible effects may result if action is not taken until science does provide such insights.”<sup>352</sup> Accordingly, the argument goes for the states to have the right to regulate their environmental measures even if they are inconsistent with scientific evidences. The precautionary principle does not undermine scientific researches or evidences but it does reflect the fact that scientific certainty is rare.<sup>353</sup>

That is why some authors opined that tribunals considering whether environmental measures are expropriatory measures should limit their inquiry to legitimate scientific methods and procedures of the evidence derived from, and is probative of a potential for adverse effects,<sup>354</sup> not motivated by a political sham.<sup>355</sup> Once the evidence is proved to be scientific and probative, the tribunal should accept the legitimate environmental basis for the measure.<sup>356</sup> However, it may be pointed out that there is no right-wrong answer in the scientific researches and every opinion has its scientific rationality, which might be reflected on the inconsistency of the environmental regulations. Therefore, basing the measures on scientific research makes the government unable to face the new environmental challenges because the scientific researchers have not covered them yet. Furthermore, objective scientific evidence that supports issuing the measures would not exempt the host state from compensating the investor where it is committed contractually towards him.<sup>357</sup>

Most of the arbitral decisions buck the opposite approach of striking a balance between environmental and other objectives as they did not indicate any particular sensitivity of the arbitrators to environmental considerations.<sup>358</sup>

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351. See Sands, *supra* note 312, at 204.

352. Wagner, *supra* note 41, at 532-33.

353. *Id.*

354. *Id.* at 534-35.

355. Moloo & Jacinto, *supra* note 294, at 33.

356. Wagner, *supra* note 41, at 534-35.

357. Moloo & Jacinto, *supra* note 294, at 33.

358. Philippe Sands, *Litigating Environmental Disputes: Courts, Tribunals and the Progressive Development of International Environmental Law* (Global Forum on International Investment

It has been suggested that where the measure is reasonable and nondiscriminatory, including those related to environmental protection, it should not be compensable even if it reduced the investment profits, but the unfair or inequitable measures that discriminate against foreign investors should be compensable even if they are justified under the environmental protection grounds.<sup>359</sup>

However, compensation may be provided to foreign investors as long as they are deprived of the expected utility of their investment because this undermines the stable framework within which the investors work. States are not deprived of their right to regulate in the public interest, including regulating the environment, with the obligation to compensate investors as long as they have no role in causing the environmental harm. In case the investors cause the environmental harm, they should not be compensated to the extent they contribute to this harm. Furthermore, the host state should expect the extent of investor's activities over its environment and bear this in mind in its negotiation with the investor. Once the host state deviates from its contractual obligations towards the foreign investors even to secure non-contractual obligations, it is required to compensate the investors for any loss resulting thereof.

#### CONCERNS ABOUT INVESTMENT-ENVIRONMENT DISPUTES

There are a number of international bodies that are concerned with different categories of disputes. States adopt selective approaches to international dispute settlements before these international bodies, and environmental disputes have no exception. Due to the absence of international judicial or quasi-judicial bodies for environmental disputes solely, environmental disputes are sprinkled before different bodies such as ICJ, the International Tribunal for the Law of the Sea ("ITLOS"), World Trade Organization ("WTO"), the European Court of Human Rights, the Inter-American Court of Human Rights, judicial bodies of regional economic integration organizations (such as the ECJ), inspection panels, international and transnational arbitral tribunals.<sup>360</sup>

Frequently, there is a growing increase in the disputes that involve international environmental agreements. Although there is no uniform provision for the dispute resolution process because treaties are negotiated individually between its parties, there are some common

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2008), at 10, <http://www.oecd.org/investment/globalforum/40311090.pdf> (last visited March 20, 2016).

359. Gantz, *supra* note 127, at 10648-49.

360. Romano, *supra* note 6, at 1054-55; Boyle, *supra* note 18, at 143.

patterns that may be found in many treaties, such as the two-tiered dispute resolution process, starting by non-binding dispute resolution such as a recourse to diplomatic means for peaceful settlement,<sup>361</sup> local litigation in host states, and/or waiting few months after submitting a dispute notice to “cool off” prior to resorting to arbitration. Binding arbitration may be involved as a dispute settlement method with requisite preconditions.<sup>362</sup>

The disputes between foreign investors and the host states often arise out of IIAs which contain an arbitration clause that invokes the ICSID, UNCITRAL or other arbitration rules in case one of their provisions is breached. A number of standards of treatment are incorporated in IIAs.<sup>363</sup> These standards constitute the basis for investors’ claims even for the ones relate to the environmental measures. 2013 has witnessed the second largest number of investment arbitration filed in one year i.e., 56 new cases to reach totally 568. Investors brought high number of claims against developed states, challenging a number of measures, particularly in renewable energy sector.<sup>364</sup>

There are a number of cases that display the interplay between the environmental measures and the investment and how the first impacts and interferes with the latter.<sup>365</sup> It should be mentioned that there are other cases that involved environmental concerns but otherwise not decided by tribunals whether because they were rejected in the jurisdictional phase, or the parties withdrew the proceedings.<sup>366</sup> Some of

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361. Romano, *supra* note 6, at 1040.

362. Franck, *supra* note 154, at 11.

363. These standards were discussed in *supra* Part II.

364. *World Investment Report 2014*, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT 15 (Jun. 24, 2014) (statement by James Zhan, Director of Division on Investment and Enterprise, UNCTAD), [http://unctad.org/Sections/dite\\_dir/docs/diae\\_stat\\_2014-06-24\\_WIR14\\_en.pdf](http://unctad.org/Sections/dite_dir/docs/diae_stat_2014-06-24_WIR14_en.pdf).

365. Such as *Parkerings-Compagniet AS v. Republic of Lithuania* ICSID Case No. ARB/05/8 (2007). See, Christiane Gerstetter and Nils Meyer-Ohlendorf, *Investor-State Dispute Settlement Under TTIP – A Risk for Environmental Regulation?*, THE ECOLOGIC INSTITUTE 11 (Dec. 31, 2013).

366. These cases include *Marion Unglaube v. Costa Rica*, which was registered with the ICSID in January 2008, involving an investor who was denied permits needed to develop a beachfront tourist project because of a legislative decree declaring an area of the beach a preserve for endangered leatherback turtles. See *Marion Unglaube v. Costa Rica*, ICSID Case No. ARB/08/1 (2012), <http://www.italaw.com/sites/default/files/case-documents/ita1052.pdf> (last visited March 20, 2016). Another ICSID case, *Vattenfall AB, et al. v. Germany* which was registered in April 2009 and then suspended in August 2010 pursuant to a settlement agreement, involved claims brought under the Energy Charter Treaty (“ECT”) relating to purportedly onerous environmental restrictions imposed on a coal-fired power plant. This case was settled by the parties and the settlement was recorded in the form of an award as per parties’ request. See *Vattenfall AB v. Federal Republic of Germany*, ICSID Case No. ARB/09/6 (2011), <https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/casedetail.aspx?CaseNo=ARB/09/6&tab=PRO> (last visited Feb. 14, 2016). See also *Philip Morris v. Uruguay*, an ICSID case registered in March 2010, involves

these cases do not have any record beyond the filing of a Notice of Intent.<sup>367</sup> On a counting basis, more than half of the arbitration claims filed by the end of 2000 involved environmental issues.<sup>368</sup> Notably, there is an unexpectedly use of the arbitral process to challenge the public measures, especially environmental ones. However, these challenges are unsuccessful in most of the cases.

However, investment-environment disputes raise some concerns regarding the powers of the tribunals in displacing the public tribunals in reviewing the environmental regulations; arbitrators' expertise; arbitrators' bias; the insufficient standards for decision-making; and the lack of transparency and public participation in the arbitration process.

*Concerns about Arbitrators Displacing Public Tribunals  
in Reviewing Regulations*

IAs grant investors the ability to challenge the host state's legitimate measures directly before an international investment tribunal to issue a final and binding award without any review based on merits. On the other hand, states, by adopting arbitration as a method to resolve the disputes, grant arbitrators significant powers to review regulatory measures that involve domestic public interest issues.<sup>369</sup>

Arbitration as a dispute settlement method was, primarily, designed to govern private commercial disputes that involve only private parties.<sup>370</sup> Investor-state arbitration differs from commercial arbitration

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claims relating to legislation which, amongst other things, precludes multiple product lines (e.g., "regular," "light," "menthol") and requires cigarette packages to be covered by graphic images of the detrimental health effects of smoking. See Philip Morris Brands Sarl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, (ICSID Case No. ARB/10/7) (2013), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC3592\\_En&caseId=C1000](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC3592_En&caseId=C1000) (last visited Feb. 14, 2016).

367. Two such cases—claims by Sunbelt and by Ketcham against Canada - were initiated in 1998 and 2000 respectively and appear to have been abandoned by the claimants. One other - Texas Water Claims (a claim by farmers in Texas against Mexico concerning alleged diversion of water) - was filed in 2004 but has not proceeded beyond a notice of intent. See Sanford E. Gaines, *Environmental Policy Implications of Investor-State Arbitration Under NAFTA Chapter 11*, THIRD NORTH AMERICAN SYMPOSIUM ON ASSESSING THE ENVIRONMENTAL EFFECTS OF TRADE 7 (Feb. 2006), available at <http://www3.cec.org/islandora/en/item/2229-environmental-policyimplications-investor-state-arbitration-under-nafta-chapter-11-en.pdf>.

368. Gaines, *supra* at note 367, at 1. See *IIA Issues Note: Recent Developments in Investor-State Dispute Settlement (ISDS)*, UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT 2 (May 2013), [http://unctad.org/en/publicationslibrary/webdiaepcb2013d3\\_en.pdf](http://unctad.org/en/publicationslibrary/webdiaepcb2013d3_en.pdf).

369. Such dangerous power over the national measures issued by states led some scholars to characterize investment arbitration as part of the evolving concept of global administrative law. See Choudhury, *supra* note 1, at 778.

370. NIGEL BLACKABY AND CONSTANTINE PARTASIDES, REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION 1, 1 (Oxford Univ. Press, 5th ed. 2009).

in two points. First, the state should be involved with its capacity as a public law party not a private party.<sup>371</sup> The second is the nature of the transactions themselves which often involve long-term investments. The *prima facie* question is whether the tribunals appropriately and legitimately have the right to review the state environmental regulations. We urge that the tribunals do not decide the validity of the environmental measures issued by the host states as they do not have the authority nor the capacity to invalidate these measures, otherwise, they assess the legitimacy of these measures in light of their economic consequences over the foreign investments.

The power of the tribunals to have jurisdiction over the environmental measures should not be eliminated. On one hand, these measures might have, in any way, an effect on foreign investment. On the other hand, states may use them as a pretext to interfere in the operation of the foreign investments through expropriation without any judicial review over such interference except of the judicial system of the state itself which most probably would be biased. Nevertheless, the tribunals' review of such measures should be adjusted to the manner in which they can do so taking into account their relative lack of expertise in the environmental field, and their position as supranational adjudicators charged with reviewing a state's regulatory policy.<sup>372</sup>

### *Concerns about Arbitrators Expertise*

Although courts have recognized generally the importance of preserving the natural heritage,<sup>373</sup> investment tribunals primarily pay more attention to business consideration more than environmental concerns.<sup>374</sup> Such inclination to subordinate the environmental policy to the investment and trade policies is manifested in Principle 16 of the *Rio Declaration* which specified that the application of the polluter-pays principle should be done without distorting international

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371. States deal with parties in two capacities either as a private or a public party. As a private party, it does not differ from the other party contracting with it, such as sale agreement. Unlikely, when it acts as a public party, there would be inequality between the parties due to its exorbitant powers and public policy authority.

372. Choudhury, *supra* note 1, at 826.

373. The Ontario Court of Appeal in *Scarborough v. R.E.F. Homes Ltd.* referred to municipal government as a "trustee of the environment." See Munro, *supra* note 308, at 114-15. In *Spraytech*, the SCC emphasized that Qu. .bec environmental legislation is concerned not only with safeguarding the environment of today, but it is also concerned with "evidence of an emerging sense of inter-generational solidarity and acknowledgment of an environmental debt to humanity and the world of tomorrow. See, Katia Opalka and Joanna Myszka, *Sustainability and the Courts: A Snapshot of Canada in 2009*, 10 SUSTAINABLE DEV. L. & POL'Y 59, 62 (2009).

374. HUNTER ET AL., *supra* note 2, at 1349.

trade and investment.<sup>375</sup> Arbitral tribunals have the authority to distinguish between environmental measures that are issued for environmental purposes or for other politically motivated purposes and so distinguish between legitimate measures and arbitrary, discriminatory or expropriatory measures. Nevertheless, it is not an easy task due to the absence of clear guidance whether through IIAs or customary international law.<sup>376</sup>

There are some mechanisms that are used by the arbitral tribunals in evaluating the legitimacy of the environmental measures. First, arbitral tribunals may seek an expertise opinion, whether party-appointed experts or tribunal-appointed experts to assess the validity of the scientific evidences submitted to support the environmental measures. Experts may appear before the tribunal as witnesses. Furthermore, cautious should be paid to the different evaluations of expert opinions, in addition to the fact that many expert statements may be submitted to the tribunals that include different, or conflicting, evaluations. Tribunals often rely on expert statements in technical issues. *Methanex* is the standing case in this regard in which the tribunal devoted much attention to the scientific evaluations.<sup>377</sup> Nevertheless, the expert statements seem not to be sufficient for the tribunals to assess the legitimacy of the environmental measures. Tribunals should take the scientific evidence as one element in evaluating the legitimacy of the measures beside other elements such as its discriminatory effect and its purpose. In the meantime, tribunals' members should not blindly follow the expert opinions as they are merely evidences that are submitted to the tribunals, which should be subject to the tribunal's tenet on the whole case.

Such insufficiency of expert statements led some commentators to suggest another mechanism by which the tribunals exercise the role of judicial review body to use "deferential standards of review" in assessing the state's endangerment finding.<sup>378</sup> This mechanism helps in determining whether the tribunal will be 'interventionist' or 'deferential' in assessing the state's action.<sup>379</sup> However, this idea is controversial especially in relation to what the appropriate standard to be applied is and how to find it. To overcome such a problem, some commentators suggested another approach by using various forms of procedural def-

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375. Marc Pallemarts, *International Environmental Law in the Age of Sustainable Development: A Critical Assessment of the Unced Process*, 15 J.L. & COM. 623, 632-33 (1996).

376. Gantz, *supra* note 89, at 655-56.

377. Marley, *supra* note 289, at 1022; Vadi, *supra* note 39, at 197-98.

378. Marley, *supra* note 289, at 1024-25.

379. *Id.*

erence to safeguard the possibility of the state taking advantage of substantive deference to act in bad faith.<sup>380</sup> As long as the investors legitimately are concerned about the illegitimate motives behind the environmental measures, the procedural deference may be used as a proxy for expertise-based decision-making.<sup>381</sup>

### *Concerns about Arbitrators Bias*

In addition to the traditional criticism of the interference in the states' powers by the investment tribunals that is unacceptable and undermines the legitimacy of the investment tribunals themselves, and the regime as a whole,<sup>382</sup> tribunals of investment-environment disputes were criticized of being biased towards the investment laws due to paying a little consideration to the complex environmental issues which would result in an inherent bias favoring the investment law over the environmental principles.

Moreover, the uncertainties that surround the investment regime might exacerbate such bias. These uncertainties include the method of constituting the investment tribunals and choosing the members of the tribunal, basically the ad hoc tribunals that decide only the cases before them, and are not formally obliged by precedents, which may lead to inconsistencies in the tribunals' approaches. Such inconsistencies extend to states that may be dissuaded from enacting the environmental measures out of the fear of being held liable.<sup>383</sup>

As a preliminary observation, the arbitral tribunals still deal with the investment-environment disputes on the basis that protecting the investment is the general rule while protecting the environment is just an exception to this general rule. Even in the cases where the tribunals held the liability of the state based on environmental measures, these cases did not introduce any solutions to the tension between the two conflicting interests, otherwise, they held the host state responsible to pay compensation for the investor. They did not introduce any mechanisms to protect the environment from the harmful investment activities nor to protect the investment from the disguising environmental measures.

It has been suggested that the following areas need to be paid more attention in balancing the relationship between investment and environmental disputes, including (1) the lack of specific provisions for the protection of health and safety; (2) the lack of a clear derogating rule

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380. *Id.* at 1030.

381. *Id.*

382. *Id.* at 1015.

383. *Id.* at 1013.



for conflicts between environmental health and safety laws on the one hand and investment agreements on the other; (3) the legitimacy of an investment tribunal passing judgment on the validity of scientific evidence relied upon by a legislature; and, (4) the appropriateness of an investment tribunal reviewing a court decision.<sup>384</sup>

*Insufficient Standards for Decision-making*

In attracting FDI to advance their economy, developing countries sometimes lower their environmental standards to increase their locational advantages to MNEs whether on their own initiative or by suggestion from MNEs themselves. The same effect applies to the non-application or lax implementation of such environmental regulations out of their impact on their locational advantages to MNEs. Powerful investors may constitute a chilling effect on the government powers to regulate in the public interest.<sup>385</sup> This chilling-effect leads to environmental standards relaxation in order to attract FDI.<sup>386</sup>

As the unanticipated fluctuation in environmental standards increases the risk of reducing the attractiveness of investment,<sup>387</sup> MNEs are prompted to improve their corporate environmental standards, so as to cope with the environmental regulatory changes in the future.<sup>388</sup> Furthermore, they can engage the host state in negotiating the environmental regulations before concluding the agreement.<sup>389</sup>

Due to their sovereignty, states clearly are free to choose relatively lower environmental standards than other states, which in turn could encourage foreign investors to pay little attention to local populations, with little or no local participation in the decision, nor local benefits from jobs or profits. That is why NGOs call for minimum national environmental standards as a prerequisite for open trade and investment.<sup>390</sup>

However, the problem of harmonizing both interests is the standard of review. Environment and investment operate at different levels of ambiguity.<sup>391</sup> This ambiguity favors investors as investment principles

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384. Hill, *supra* note 130, at 167-68.

385. Vadi, *supra* note 39, at 831-32. For example, in 2002, some foreign investors threatened Indonesia to initiate arbitration in response to its ban on open-pit mining in protected forests. Six months later, the Ministry of Forestry agreed to change the forest designation from protected to production forests. *Id.*

386. UNCTAD, ENVIRONMENT, *supra* note 4, at 8-9.

387. Martin, *supra* note 31, at 256-57.

388. *Id.*

389. *Id.* at 257-58.

390. HUNTER ET AL., *supra* note 2, at 1343-44.

391. Lilley, *supra* note 182, at 743-44.

and rules are relatively clearer than the environmental ones, at least for the tribunals' members who decide the cases involving such conflicts. The second problem is the scientific uncertainty that affect environmental issues.<sup>392</sup> It should be mentioned that arbitral decisions that assess the legitimacy of environmental impact assessment often reach the same conclusions analogous to parallel jurisprudence of ICJ.<sup>393</sup>

The *Metalclad* decision is a distinctive decision because it was the first instance to hold a government liable for damages.<sup>394</sup> This decision was clear in holding an environmental measure, ecological decree, as an expropriatory measure. In scrutinizing this decision, it could be said that the tribunal weighed the investor's rights over the environmental protection concerns. As a result, this decision raised various reactions in both environmentalists and public groups that were concerned with the chilling effect of such decision, and other similar decisions, on future lawmaking. On one hand, this decision would eventually affect the governments' capability to enact environmental measures due to the fear of potential liability. On the other hand, governments might need to conduct a cost analysis before contemplating the enactment of environmental regulations.<sup>395</sup> Furthermore, this decision was criticized as an abuse of Chapter 11's of NAFTA in a manner not intended by its parties.<sup>396</sup> Such decision deemed to crystalize a trend of using Chapter 11 as a tool of favoring MNE's potential profits over the existing legitimate exercise of sovereignty by governments and denying the public its uninhibited right to sound environment.<sup>397</sup>

More importantly, the *Metalclad* decision shows that the tribunals are no longer shrinking from interpreting local laws nor from ignoring their official interpretation and adopting their own interpretations.<sup>398</sup> Ignoring the environmental concerns by the tribunal means that it dismisses the government's interests in serving its public policy that underlines its measures. Notably, the tribunal recognized the local authorities to exercise the police powers for the purpose of protecting

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392. *Id.*

393. Vadi, *supra* note 39, at 202.

394. *Metalclad* decision, *supra* note 318.

395. Byrnes, *supra* note 274, at 103.

396. Lucien J. Dhooze, *The North American Free Trade Agreement and the Environment: The Lessons of Metalclad Corporation v. United Mexican States*, 10 MINN. J. GLOBAL TRADE 209, 213 (2001).

397. *Id.*

398. Dhooze, *supra* note 396, at 260.

the health, which covers the environmental measures.<sup>399</sup> However, exercising such police powers exception should be based on a legitimate substantial interest, which should be subject to reasonable standards. These standards assume that the environmental risk sought to be protected by the measure is real and substantial which may be proved by scientific evidence. Accordingly, the camouflaged environmental measures that in fact serve other illegitimate purposes would be eliminated.

One of the drastic consequences of the *Metalclad* decision is the regulatory gridlock that may be incapable of coping with environmental emergencies as well as scientific advances in an adequate manner.<sup>400</sup> It might be seen also as a way of thwarting environmental measures that would not be able to be thwarted domestically.<sup>401</sup> In addition, this extreme trend of expropriation claims may be used by the foreign investors as a tool to extract huge settlements from host states under expansive expropriation claims based on environmental measures.<sup>402</sup>

Furthermore, issuing environmental measures should involve due process. However, *Metlaclad* procedures were convicted as undemocratic due to their secrecy and violating due process.<sup>403</sup> This decision shows the significance of enhancing the due process and transparency in investment-environment disputes.

#### *Lack of Transparency; Third Party Participation*

Transparency plays an important role in investment-environment disputes. Transparency refers to the extent by which the public should be aware, or even participate, in a proceeding where public interests are at stake. How governments use transparency to enhance their public interests, how tribunals deal with transparency alongside the proceedings and to what extent transparency may affect the due process? These questions, and those developed over our discussion, represent a core part in investor-state dispute which would contribute to enhancing the legitimacy of the mechanism itself.

Investment arbitration has been criticized by the OECD as a non-transparent and inefficient process due to the restrictions of public-

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399. *Id.* at 263.

400. *Id.* at 273-74.

401. *Id.* at 276-77.

402. Lauren E. Godshall, *In the Cold Shadow of Metalclad: The Potential for Change to NAFTA's Chapter Eleven*, 11 N.Y.U. ENVTL. L.J. 264, 314-15 (2002).

403. Dhooze, *supra* note 396, at 213.

disclosure.<sup>404</sup> Tribunals should assess the legitimacy of the process that led to the challenged measure. In *Waste Management v. Mexico*, the tribunal referred to the minimum standard being breached where there is a complete lack of transparency and candor in an administrative process.<sup>405</sup> The lack of public transparency in the arbitral process obscures the process itself. There is no formal way of announcing the claims and once the tribunal is duly constituted, the process becomes confidential, the hearings take place behind the doors, similar to private commercial disputes,<sup>406</sup> and no requirement for publishing the decisions. That is why environmentalists view investor-state as frustrating the goals of sustainable development.<sup>407</sup>

A core related question is to what extent MNEs are responsible for increasing their transparency in their environmental affairs? Normally, governments of developed nations use their coercive powers to increase MNEs' transparency in relation to the environmental affairs by embracing dispositions favoring global environmental health over unregulated investment marketplace,<sup>408</sup> which reflects an environmental consciousness in MNEs' decision making process.<sup>409</sup> Furthermore, it would enhance the local enterprises performance that try to match the environmental standards of the foreign competitors. Accordingly, when MNEs behave in an environmentally responsible framework, the host state elevates its environmental standards to develop a better environmental framework.<sup>410</sup> The transparency of the environmental accountability may be evidenced by the environmental impact assessment reports.<sup>411</sup>

States are obliged to respect and protect freedom of expression, including the freedom to seek, receive, and impart information.<sup>412</sup> Therefore, the lack of transparency in investor-state arbitration may

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404. Newcombe, *supra* note 48, at 431.

405. *Waste Management, Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/00/3, Award, ¶ 98 (Apr. 30, 2004), <http://www.state.gov/documents/organization/34643.pdf>.

406. David Schorr, director of WWF's Sustainable Commerce Program said, "A procedure designed to settle private commercial disputes is being used to rewrite important public policies behind closed doors." Julia Ferguson, *supra* note 248, at 514-15.

407. Martin, *supra* note 31, at 225.

408. *Id.* at 252.

409. *Id.* at 250-51.

410. *Id.* at 252.

411. *See id.* at 250-51 for a survey on the reports on issues of environmental responsibility.

412. Article 19 of the International Covenant on Civil and Political Rights places upon states the duty to respect, protect and fulfill the human right to freedom of expression, which includes the "freedom to seek, receive and impart information and ideas of all kind, regardless of frontiers, either orally, in writing or in print, in the form of art, or through any other media of his choice." Oct. 5, 1977, 999 T.S. 172, *available at* <https://treaties.un.org/doc/Publication/UNTS/Volume%20999/volume-999-I-14668-English.pdf>.

hold the state liable for breaching its human rights' duty to protect freedom of expression.<sup>413</sup>

Although the ICSID Convention and Rules do not protect confidentiality, investment tribunals have recognized the transparency requirement.<sup>414</sup> Transparency gives the public an opportunity to monitor the proceeding and assess its outcome due to the public interests at stake in these disputes. Lack of transparency undermines this possibility and nurtures the belief that awards are unjust and resulted from procedural biases.<sup>415</sup> Therefore, many arbitral proceedings make available the submitted documents to the public.<sup>416</sup> In *Methanex*, the tribunal pointed out the public interests at stake and inclined to accept amicus submissions due to the public concerns involved in the issue.<sup>417</sup> This case witnessed a broad application of the amicus provisions stipulated in ICSID Rules.<sup>418</sup> In *Metalclad*, due to the absence of transparency requirement in Chapter 11, the tribunal relied on Article 102(1), which states the objective of NAFTA, to transplant the transparency requirement.<sup>419</sup>

Unlike NAFTA,<sup>420</sup> CAFTA requires the hearings to be opened to the public and the documents to be made public.<sup>421</sup> Nevertheless, some stakeholders might have an interest to participate in the proceedings that involve a public interest. Out of transparent proceed-

413. Bijlmakers, *supra* note 7, at 262-63.

414. Joachim Delaney & Daniel Barstow Magraw, *Procedural Transparency*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 759 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008) ("The Convention and the Rules do not prevent the parties from revealing their case."). This view was affirmed in *Amco Asia Corporation v. Republic of Indonesia*, (ICSID Case No. ARB/81/1) Dec. on Request for Provisional Measures, 400, 412 (Dec. 9, 1983) 1 ICSID Rep. 569 (1993) and *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award, ¶ 13 (Aug. 30, 2000), [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542\\_En&caseId=C155](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542_En&caseId=C155).

415. Bijlmakers, *supra* note 7, at 265

416. For example, the U.S. made available the related documents in *Lowen v. United States* and Canada has provided full public access to documents in the *Ethyl v. Canada*. *Methanex* has posted several documents on its web site. See, Ferguson, *supra* note 248, at 506.

417. *Methanex Corp. v. United States*, Decision of the Tribunal on Petitions from Third Persons to Intervene as Amici Curiae, ¶ 49 (NAFTA Ch. 11 Arb. Trib. Jan. 15, 2001); Delaney & Barstow, *supra* note 414, at 760.

418. The Tribunal received two applications for permission to file a non-disputing party submission: (i) the application for amicus curiae status by International Institute for Sustainable Development dated 9th March 2004, and (ii) the application of non-disputing parties for leave to file a written submission by Earth justice on behalf of Bluewater Network, Communities for a Better Environment and Center for International Environmental Law, also dated 9th March 2004. *Id.* para 28.

419. Munro, *supra* note 308, at 106-07.

420. For the differences between NAFTA and CAFTA, see *supra* Part III(1).

421. Wang, *supra* note 5, at 275-76.

ings, those stakeholders may participate in the proceedings through “amicus submission”.

ICSID Rules provide for amicus submissions in certain situations and pursuant to the discretionary power of the arbitral tribunal itself.<sup>422</sup> NAFTA tribunals consider accepting such submission a *de facto* practice, such as *Metalclad* tribunal. Additionally, tribunals sometimes invite the public to view the proceedings. For instance, the *Glamis Gold* tribunal invited the public to view the proceedings in a separate room via closed circuit television.<sup>423</sup>

The opacity that takes place under the cloak of confidentiality constituted an asymmetry of the FDI arbitration procedures and violate basic guarantees of public access. From a democratic point of view, FDI arbitration was considered ill-suited to address complex public matters.<sup>424</sup> The amicus brief is the closely related method to democratic measures that permit the publication of documents and open public hearings in investment disputes<sup>425</sup> because they often attract intense public scrutiny.<sup>426</sup>

Traditionally, investment arbitration, as the commercial arbitration, was focusing on the privity of the parties and the consensual nature of the arbitration. With the growing trend of investment disputes and the introduction of the public interest concepts at stake, there might be some non-disputing parties who are affected by these proceedings and want to show up before the tribunal to present their views about the dispute in a neutral way. This state of mind about the public interest concept favored the acceptance of amicus briefs.

However, the issue of amicus curiae was regulated solely by each arbitral tribunal without any regulatory framework to work through. The first tribunal to deal with the amicus curiae submission was *suez-Vivendi*, by a way of acknowledging the transparency of investment arbitration.<sup>427</sup> This decision sets out three condition for amicus to participate in the proceedings as follows a) appropriateness of the subject matter, b) suitability of a non-party to act as amicus curiae, and c) the procedure by which the amicus submission is made and considered.<sup>428</sup> The first amicus request in regard to environmental

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422. ICSID Arb. R. 37(2) (amended 2006).

423. See Vadi, *supra* note 39, at 879-80.

424. Bijlmakers, *supra* note 7, at 266.

425. Choudhury, *supra* note 1, at 814.

426. *Id.*

427. Delaney & Barstow, *supra* note 414, at 756-57; Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A v. The Argentine Republic award (ICSID Case No. ARB/03/19), <http://www.italaw.com/documents/SuezVivendiAWGDecisiononLiability.pdf>.

428. Footer, *supra* note 8, at 51-52.

concerns was made in the *Aguas del Tunari* case but eventually it was rejected.<sup>429</sup>

Furthermore, the *Methanex* decision was a significant win for the environmentalists in which they fought against the lack of transparency in this proceedings in addition to submitting many petitions to the UNCITRAL body to allow amicus briefs until the tribunal issued a surprising award that allowed the amicus input.<sup>430</sup> Although this award does not bind UNCITRAL bodies nor other tribunals, it led to an explicit modification of NAFTA provisions to secure the *amicus* participation.<sup>431</sup>

Furthermore, the use of amicus briefs increased in practice, which led the World Bank, in 2006, to amend its ICSID Arbitration Rules to open the door for CSOs to submit their briefs before the investment tribunals.<sup>432</sup> Such development in non-party participation in investment disputes pushed governments to include similar clauses in their investment treaties.<sup>433</sup> This ensures environmental groups and other public advocacy organizations that their voices will be heard.<sup>434</sup>

As long as non-disputing parties such as environmental groups argue for transparency and nonparty submission rights, equally it can be argued for business promotion groups who may have an interest in being heard on the side of aggrieved investors. The *Glamis* case is an important case in this regard as it pointed out the fact that amicus submissions can be favoring either side.<sup>435</sup>

The amicus brief is one tool for the tribunals to assess the environmental endangerment of the investment activities. Amicus briefs allow the participation of CSG, such as NGOs, which in turn may effectively account for the tribunals' public law role in the cases involving environmental issues.<sup>436</sup> Allowing non-disputing party participation through amicus briefs is beneficial to states especially in regard

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429. *Id.* at 51.

430. Hill, *supra* note 130, at 165; Marley, *supra* note 289, at 1020-21; Gaines, *supra* note 467, at 6.

431. Hill, *supra* note 130, at 165.

432. The 2003 Statement of the Free Trade Commission on Non-Disputing Party Participation under NAFTA has the same rule. See U.S. DEPARTMENT OF STATE, <http://www.state.gov/documents/organization/38791.pdf>.

433. Footer, *supra* note 8, at 34.

434. Byrnes, *supra* note 274, at 54.

435. Jean E. Kalicki, *The Prospects for Amicus Submissions, Outside the ICSID Rules*, KLUWER ARB. BLOG (Sep. 14, 2012), <http://kluwerarbitrationblog.com/blog/2012/09/14/the-prospects-for-amicus-submissions-outside-the-icsid-rules>.

436. Marley, *supra* note 289, at 1031-32; Choudhury, *supra* note 1, at 815-16.

to environmental measures to show the importance of the impugned measures from an environmental perspective.<sup>437</sup>

However, the amicus method is subject to a number of criticisms. First, third parties' participation in the arbitral proceedings – through amicus or any other way – would lead to judicialization of the arbitral proceedings so far which is an avoidable consequence of arbitration as it would increase the costs and time of the arbitral process itself. Second, according to the party autonomy principle, BIT is the basis for foreign investor's claims and non-disputing third parties or stakeholders are not parties to such BIT. This would collide with the host state's legitimate expectation as it legitimately expects who would be its counter party in the dispute.<sup>438</sup> Additionally, host state does not know the identity of those potential stakeholders nor their numbers. Third, such potential judicialization of the arbitral process would ultimately re-politicize the investment disputes.<sup>439</sup> However, amicus submissions might offer important assertions of fact to which the parties may feel welcoming such submissions. Nevertheless, such factual assertions or technical expertise offered by amicus submissions might be argued to be tested by the parties through cross-examination. Accordingly, the tribunal would evaluate the persuasive value of the arguments not the amici.<sup>440</sup> However, these criticisms should not eliminate the functional rule of amicus as far as calling for regulating it through sound procedural framework.

#### PROPOSED REGIMES

The growing trend of investment flows may result in a real threat to the environmental framework of the host states and at the end, the environment will pay the price.<sup>441</sup> Such a policy will leave no room for the “polluter pays” principle to operate which will in turn undermine the sound environment. Therefore, all the related parties, including investors, governments, and third parties, started to formulate “green investment strategies” in order to burgeoning the capital flows in a much sound environmental framework.<sup>442</sup>

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437. Marley, *supra* note 289, at 1033-34; *see also* Vadi, *supra* note 39, at 882-83 (explaining the importance of amicus briefs for indigenous people in disputes relating to them and referring to Glamis case).

438. It may be argued that the amicus briefs are submitted from a neutral point of view but in fact this is a pure theoretical view but in practice the submission favors either side of the dispute.

439. Vadi, *supra* note 39, at 885.

440. Kalicki, *supra* note 435.

441. Ferguson, *supra* note 248, at 516.

442. HUNTER ET AL., *supra* note 2, at 1345.



Although the environmental investment disputes are of essence in the investment field, there is no refinement to the environmental regimes within the sphere of investment. The investment regime needs a mechanism that properly and efficiently addresses these complicated issues. Authors vary in their suggestions to these mechanisms between substantive and procedural mechanisms. While some suggestions go for adjusting the interpretation of the environmental provisions in investment treaties, others go for creating an investment court that controls and functions as a constitutional guardian for proper application of these regimes. It is hoped that the following reflections will serve as a catalyst for discussion and debate among practitioners in an attempt to contribute to addressing the tensions between both bodies of the law and policy.

Any treatment of the investment-environment interface is incomplete without some consideration of the proposed methods that are likely to have immeasurable impact on the whole system of the investment arbitration. In considering our proposed regimes, we begin first with the substantive proposed regimes that include the enhancement of the EIA, reviewing the BITs provisions, the Corporate Social Responsibility (“CSR”), and the rationale of compensation. Second, we discuss the procedural proposed regimes that include the creation of the investment court, the mechanism of counterclaim by states in investment arbitration, and finally proposing the so called “Reconciliation Committee”.

First of all, states should regularly review the IIAs to which they are party to update them in light of the development of the environmental field and other sustainable resources that may better serve the public interest. Such review should be reconciled pursuant to domestic and international environmental standards and should involve the current foreign investors whose projects may be affected by such review.

In 2011, the OECD-hosted Freedom of Investment (FOI) discussed the role of international investment in supporting the green growth objectives of the countries.<sup>443</sup> The OECD urges the governments to examine:

[W]hether their investment treaty practices are up-to-date with regard to environmental concerns and consider including language in investment treaties or environmental treaties to provide guidance about how environmental and investment law goals are to be reconciled . . . Governments should seek to ensure that, where relevant,

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443. They came up with a draft statement that links the investment with the environment in different areas, it may be accessed at <http://www.oecd.org/investment/internationalinvestmentagreements/46905672.pdf>.

the ISDS system adequately integrates and balances the goals of international environmental and investment law. To the greatest extent possible, governments should strive to ensure that the ISDS system adequately addresses the application of investment law to environmental measures in a transparent and publicly accountable manner that allows, where appropriate, participation by interested third parties. In order to ensure a consistent treatment of this issue, governments should consider including provisions on transparency of ISDS in their investment agreements.<sup>444</sup>

### Substantive Proposed Regimes

#### Environmental Impact Assessment (“EIA”)

EIA may be used as an instrument to assess the environmental risk management and ensure that the decision-making process takes the environmental concerns into account. Simultaneously, EIA enhances the sound decision making process.<sup>445</sup> Each investment activity should be subject to the EIA in order to evaluate clearly its potential environmental impacts before making the decision. Notably, EIA is required by a number of IIAs.<sup>446</sup>

Although the EIA is now a common practice in investments involving environmental issues and growingly recognized by most of the treaties and considered one of the important environmental tools, its scope and content is not determined.<sup>447</sup> In addition, the parties may intend to give some treaty provisions a meaning that capable of evolving over time without having a solid or fixed meaning. Such terms should be interpreted in light of the practice and performance of these obligations.

EIA should be conducted independently alongside the development of investment agreements. All the issues being negotiated should be considered from the point of their impact upon the environment. A panel of independent non-stakeholder experts may be constituted to act as “friends of the Chair” in order to give their advices about the environmental implications of various proposals.<sup>448</sup> This pre-assess-

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444. *Id.* at 5-6.

445. Valentina S. Vadi, *Environmental Impact Assessment in Investment Disputes: Method, Governance and Jurisprudence*, 30 *POLISH Y.B. INT’L L.* 169, 170 (2010).

446. The Rio Declaration on Environment and Development, the Convention on Environmental Impact Assessment in a Trans-boundary Context (Espoo Convention), the 2001 International Law Commission Draft Articles on Prevention of Trans-boundary Harm from Hazardous Activities, and the UNEP Goals and Principles 21 require EIA require EIA.

447. *Pulp Mills (Arg. v. Uru.)*, 2010 I.C.J. 14, ¶ 25 (Apr. 20) (the International Court of Justice, in the *Pulp Mills* Case, observed that “general international law” does not “specify the scope and content of an environmental impact assessment.”) *available at* <http://www.icj-cij.org/docket/files/135/15877.pdf>.

448. Mann, *supra* note 249, at 407-08.

ment process would ensure that the review is timely and prevents the unintended consequences. This proposal purports to complement the goal of investment law to operate in a sound environment.

Substantively, EIA should be based on scientific evidences and reflects the effectiveness and candid about uncertain issues in addition to being well reasoned. Procedurally, EIA enhances the transparency of the decision making process by which it involves public participation and consultation and being accessible to the private stakeholders. The public should understand the environmental impact of the proposed activities and express their views to the decision makers because they might be affected by the environmental degradation and would be exposed to pollution. Public participation is necessary because such issues involve matters of public governance and they would provide the authorities with valuable data that help in decision making and on the other hand, it would enhance the legitimacy of the decision making process.<sup>449</sup> Furthermore, arbitral tribunals would pay much attention to the procedural fairness attached to the EIA, which in turn can embody the environmental concerns into the economic interests while respecting both bodies of law.<sup>450</sup>

#### BIT Provisions

As discussed earlier, reference to environmental concerns in IIAs may take different methods,<sup>451</sup> whether by ignoring it at all, addressing it in general and hortatory provisions, addressing environmental concerns in specific clauses that affirm the host state's powers to protect environment, including the pledge not to lower environmental standards to attract investment, or finally, incorporating mandatory obligations to observe certain environmental standards such as environmental sound technology and management practice.<sup>452</sup>

It would be more convenient to directly address the environmental concerns in a clear cut provisions<sup>453</sup> that gives states the self-power to protect their environment without harming the investor's property in light of the agreed upon standards to be negotiated between the state and the investors in a transparent way.<sup>454</sup> This approach would give

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449. Vadi, *supra* note 445, at 179.

450. *Id.* at 201.

451. *See supra* Part III(C)(2)(a).

452. UNCTAD-Environment, *supra* note 4, at 3; *see supra* Part III(C)(2) (for more details).

453. *See* CAFTA *supra* note 283, at 43-44.

454. Agreement for the Reciprocal Promotion and Protection of Investment Law, Belg.-Lux.-Eth., Oct. 26, 2006, UNCTAD.org *available at* [http://unctad.org/Sections/dite\\_tobedeleted/ iia/ docs/bits/BLEU-Ethiopie-eng.pdf](http://unctad.org/Sections/dite_tobedeleted/ iia/ docs/bits/BLEU-Ethiopie-eng.pdf) (a good approach is adopted by Belgium/Luxembourg by combining the reservation of policy space with a specific definition of environmental laws. The

arbitrators clear guidance in striking the balance between environmental regulations and investment protection. Nevertheless, the question remains as to the method of interpretation to these environmental provisions?

### Interpretation of Environmental Issues

The interpretation of BITs ranges pursuant to the degree on which emerging customary norms and principles relating to sustainable development impact pre-existing treaties. The role of international investment in the economic development was recognized in the preamble of the ICSID Convention. The question is whether this reference to economic development should be interpreted in terms of sustainable development.<sup>455</sup>

Arbitral tribunals have rarely addressed the non-investment law principles.<sup>456</sup> Nevertheless, arbitrators should deploy the interpretation tools to the harmonization of the term experience and the common sense.<sup>457</sup> The challenge in itself is how to adjust the interpretation rules to be consistent with the legitimacy of international legal order which requires the melding of different parts of the international legal order and its development, including international economic law and international environmental law, by the tribunals' members. However, the interpretation rules should be used on an equal footing for both parties and tribunals should not use them to favoring the investor interests or other non-investment interests over another.

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provision reads as "Recognising the right of each Contracting Parties recognise to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental legislation. Each Contracting Party shall strive to ensure that its legislation provide for high levels of environmental protection and shall strive to continue to improve this legislation . . . "environmental legislation" means: any legislation of the Contracting Parties in force at the date of the signature of this Agreement or passed after the date thereof or provision of such legislation, the primary purpose of which is the protection of the environment, or the prevention of a danger to human, animal, or plant life or health, through: a) the prevention, abatement or control of the release, discharge, or emission of pollutants or environmental contaminants; b) the control of environmentally hazardous or toxic chemicals, substances, materials and wastes, and the dissemination of information related thereto; c) the protection or conservation of wild flora or fauna, including endangered species, their habitat, and specially protected natural areas in the Contracting Party's territory.").

455. Orellana, *supra* note 48, at 715.

456. Vadi, *supra* note 39, at 866-67.

457. *See supra* Part III(C)(2)(b).

### Interpretation Supervisory Body

Due to the inadequacies in organizing the FDI, some developed nations and international institutions are calling for supervisory bodies to oversee BIT performance.<sup>458</sup> This has induced some commentators to propose attaching concurrent negotiations for environmental conditions to FDI negotiations which would be based on a priority list of the prevailing environmental ills in each developing nation, ranging from absent or inadequate environmental standards, to negligent enforcement of existing regulations.<sup>459</sup> This priority list would focus on all areas most in need of improvement for each developing nation.<sup>460</sup> It has to be applied equally and on a competitive basis with a uniform and thorough set of rules governing FDI. This way would strengthen the bargaining position of the developing states in negotiating foreign investment agreements.<sup>461</sup> As the unanticipated fluctuation in environmental standards increases the risk of reducing attractiveness of investment, MNEs are prompted to improve their corporate environmental standards, so as to cope with the environmental regulatory changes in the future.<sup>462</sup> Furthermore, they can engage the host state in negotiating environmental regulations before concluding the agreement.<sup>463</sup>

### Corporate Social Responsibility ("CSR")

International corporations and multinational enterprises play an important role in striking the balance between investment protection and environmental protection. This role can be manifested by the CSR. The harm that occurs to the environment is attributable to these corporations as one of their wrong doings. To what extent these enterprises responsible for such wrong doings, which may constitute a violation of the international human rights obligations on non-governmental entities in the private sphere?

This issue has a deep complexity because the states, not corporations, are considered, under international law, responsible for securing the environmental protection and fundamental human rights. MNE's

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458. See Martin, *supra* note 31, at 230-31 (the Overseas Private Investment Corporation (OPIC) is established by the United States to ensure the environmentally sound performance of its BITs in developing countries).

459. *Id.* at 238-39.

460. *Id.* at 240.

461. *Id.* at 238-39.

462. *Id.* at 256-57.

463. *Id.* at 257-58.

failure to uphold basic economic and social rights will result in a legal redress against this MNE in national courts of the host state.<sup>464</sup>

The draft Norwegian Model BIT in Article 32 has referred to CSR to conduct the investment in compliance with the OECD Guidelines on MNEs and to participate in United Nations Global Compact.<sup>465</sup> The OECD Guidelines assert that MNEs should refrain from seeking or accepting exemptions from environmental measures that are not contemplated in the statutory or regulatory framework.<sup>466</sup> Notably, some non-OECD countries like Argentina, Brazil, Chile, and Slovakia had already committed themselves to such efforts.<sup>467</sup> Although this draft was withdrawn in 2009 by the Norwegian government, it distributed an English-language version of its CSR policy, which was the first step to hardening up some of the soft CSR standards which was resonated in BITs and other forms of IIAs.<sup>468</sup>

Some authors suggest that the host country acts as an “insurer of last resort” where it is not possible to sue a private corporation that causes the harm directly, the country might be held liable under international law as the harm was originated within its borders.<sup>469</sup> This risk of responsibility may encourage countries to enact precautionary or preventive measures through enacting legislations to protect its environment.<sup>470</sup>

Possibly, states may refer to foreign investor’s corporate social responsibility as a defense to investor’s claim and to justify its regulatory reaction for failure to comply with the basic standards of CSR. Nevertheless, arbitral tribunals may construe CSR provisions narrowly or totally ignore them due to their soft or non-binding language.<sup>471</sup>

Since 1990, corporations started publishing policies of corporate responsibility to discuss various issues including environmental ones. These policies vary from weak policies that include general pledges to

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464. Footer, *supra* note 8, at 58-60 (stating that in 1999, the European Parliament adopted a code of conduct for European enterprises operating in developing countries to combine international minimum standards in matters related to human rights, labour standards and environmental protection).

465. See Article 32 of the draft Norway Agreement, available at <http://investmentpolicyhub.unctad.org/Download/TreatyFile/2873>; see also Peter Muchlinski, *Corporate Social Responsibility*, in *THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW*, at 666 (2008).

466. *Id.* at 671-72. The Guidelines may be accessed at <http://www.oecd.org/daf/inv/mne/48004323.pdf>.

467. Footer, *supra* note 8, at 61-62.

468. *Id.*

469. Muchlinski, *supra* note 465, at 669.

470. *Id.*

471. Footer, *supra* note 8, at 62-63.

strong policies that provide for commitment engagement.<sup>472</sup> Some commentators recommend that international investment law should address the concept of International Corporate Social Responsibility (“ICSR”), which benefit the investment itself.<sup>473</sup> ICSR recognizes the relationships between business activities and social actors.<sup>474</sup> Society involvement is one way that determines the success in promoting economic prosperity and environmental sustainability.<sup>475</sup>

CSR is an advanced development in the interaction between investment activities and social interests in general. The CSR would act as a transparent framework for the MNEs and the host states. MNEs would know the extent by which they could perform their activities and the obligations result thereof. States in preserving their social interests would know the extent by which their measures would affect the MNEs. States on the other hand may rely on the CSR policies in supporting their enactment of the measures.

#### The Rationale of Compensation

Environmental measures primarily are not different from any other measures issued by the state under the cloak of its powers to regulate its fundamental interests, especially those related to the public interests, such as the environmental concerns. The controversy is not about the state’s powers to issue these measures but the misuse of such powers to issue these measures for other purposes not related to the public interests. Therefore, the focus should be addressed to how these measures are issued through a proper procedural and substantial framework that guarantees that the state would not deviate from its basic purposes of protecting the public interests including the environmental ones.

The presumption is that the environmental measures should be considered of the state’s police powers unless it has been proved otherwise by the investor.<sup>476</sup> Accordingly, the state has a refutable presumption that its environmental measures are legitimately justified and if the investor believes otherwise, he should prove this.

In relation to the compensation, a distinction should be drawn between the total deprivation of the investment property where the in-

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472. Ahmad, *supra* note 9, at 8.

473. *Id.* 14-15.

474. *Id.*

475. Steve Charnovitz, *Reflections on North American Environmental Cooperation*, 28 CAN.-U.S. L.J. 489, 494 (2002).

476. See UNCTAD, *EXPROPRIATION*, *supra* note 125, at 92 (similarly, states under international law are presumed to act in good faith unless otherwise is proved, and States’ acts enjoy a presumption of validity).

vestor should receive a “full compensation” including the loss of profit and the expected gain, not only the fair market of the assets, and the interference with the investor’s control or the utility of the property confiscated, the compensation should be based on the fair market because the investor still enjoys the control over the property even if such control is restricted or the utility of the property is eliminated by the measure.

The full compensation is necessary for the total deprivation because it reflects recklessness from the State to the extent that it did not foresee the normal consequences of the investment activities. The idea of the full compensation is inspired from the concept of punitive damages by which the full compensation may exceed the normal damages in order to punish the state. On another note, it would be more appropriate to refer to the environmental measures in the IIAs and the extent by which the state may issue environmental measures. This would assure the investor’s legitimate expectation. In addition, it would constitute the framework within which the state exercises its authority and it will not be able to proceed this framework except for exceptional necessity and in all cases, investors should be adequately compensated for the loss they suffer regardless of the State’s motivations for such measures. However, these motivations may be a decisive factor in the value of the compensation itself not the basis of it.

### *Procedural Proposed Regimes*

#### International Investment Court (“IIC”)

Parallel to the ICJ and the different chambers it has to resolve different spectrums of disputes, an International Investment Court (“IIC”) could be a step in the right path to harmonize the investment related disputes, including the environmental-investment disputes. Alternatively, many authors call for creating an appellate body for the investment disputes that would increase the degree of certainty and efficiency of the arbitral decisions.<sup>477</sup> This appellate review body would be parallel to the WTO appellate body.<sup>478</sup> Many of the arbitral cases are appealed to the designated court of the seat of arbitration, such as *Metalclad* decision. However, there are some doubts about the role of the appellate body in regard to its relation to investment

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477. Asif H Qureshi, *Chapter 28 An Appellate System In International Investment Arbitration*, in *THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW*, at 1167 (Peter Muchlinski, Frederico Ortino and Christoph Schreuer, eds. 2008).

478. See CAFTA *supra* note 283, Article 10.20.10 (CAFTA requires negotiations for the establishment of an appellate body for review of awards); see *supra* Part III(C)(1)).



and whether it would be more or less friendly to investor interests than a court of the *situs* country.<sup>479</sup>

Nevertheless, the IIC is superior to the concept of an appellate body as it encompasses the whole disputes related to investment of whatever nature. The IIC would have a constitutional function in the investment field and would act as a guardian of the fundamental principles upon which the investment regime is based in addition to the development dimensions.<sup>480</sup> The IIC would be the principal adjudicatory body for the investment disputes and facilitate the tensions between different investment regimes and the application of general international law, including environmental law, in the investment sphere.<sup>481</sup> It would consider the relevant environmental issues on equal footing with the investment issues which precludes the automatic superiority of the investment issues over environmental issues by the tribunals that deals with such disputes from the perspective of investment rules not environmental ones.

In conclusion, the IIC could perform a fundamental, overarching, and above all constitutional role in international investment relations this constitutional role is particularly evident in its guardianship of fundamental principles and procedures, in its function in the development of international investment norms, and in its advisory and conflict-resolving role for and between different legal regimes.<sup>482</sup>

### Counter Claims in Investment Arbitration

Part of the natural justice that afford both parties to the same dispute an equal opportunity to present their cases, investment treaties should allow the host states to file counter claims against foreign investors to make a procedural balance of the competing or conflicting interests. States have the right to defend its environmental framework against harmful practices of investors and claim for compensation thereof. Indeed, some recent investment treaties specifically allow counterclaims against investors who initiate the investor-state process.<sup>483</sup> Host states may file the counterclaim for its own or on behalf of its citizens who suffered some harm from the foreign investment activities.<sup>484</sup>

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479. Wang, *supra* note 5, at 277.

480. Qureshi, *supra* note 477, at 1166.

481. *Id.* at 1167.

482. *Id.*

483. Vadi, *supra* note 39, at 884-85.

484. *Id.*

Practically, the investment tribunals do dismiss counter claims filed by the host states, allowing only foreign investors to file claims against the host states, which appear only as Respondents not Claimants. Furthermore, the system of investment arbitration is used as sword for the foreign investors and as a shield for the host states. If the host state decides to sue the foreign investors for the harmful practices over the environment, it has to follow a different way of justice other than arbitration. This was the practice of investment tribunals until 2012.

In 2012, an unprecedented award was issued that affirmed the jurisdiction of the tribunal over the State's Counterclaim. This was the first decision in IIA arbitration of its kind. In *Goetz*,<sup>485</sup> Burundi sought US\$ 1 million from the claimants for their bank's failure to honour the terms of a local operating certificate. Although the applicable BIT was silent on the issue of counterclaim, the tribunal decided that it was competent to consider the counterclaim pursuant to Article 46 of the ICSID Convention as the counterclaim fell within the jurisdiction of ICSID (i.e., related to the investment). Having admitted the counterclaim, the tribunal went on to dismiss it on the merits.<sup>486</sup>

This procedural development in the investment arbitration would be a great step of balancing the conflicting interests. According to this unprecedented step, the presumption that States may issue environmental measures tainted by other illegitimate purposes would be refuted by this procedural guarantee for the state itself. Tribunals would be able to balance the situation from both equivalent perspectives.

Nevertheless, this view would face some practical obstacles in its application because most of the investment tribunals are reluctant to accept States to appear as Claimant in Counterclaims. In addition, the precedents system does not apply in arbitration and hence, the subsequent tribunals are not obliged to follow the *Goetz* tribunal. Notably, the *Goetz* decision was issued by a tribunal's members of civil law background who are more lenient to accepting the counter claims.<sup>487</sup> Most of the other cases that rejected the filing of the counterclaim were consisting of common law arbitrators. This might shed a light on the way of constituting the tribunals which is a strategic decision. The

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485. *Goetz v. Republic of Burundi*, ICSID Case No. ARB/01/2, Sentence, ¶ 127 (June 21, 2012), [https://icsid.worldbankorg/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2651\\_Fr&caseId=C2](https://icsid.worldbankorg/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC2651_Fr&caseId=C2).

486. *Id.*

487. The tribunals' members were Gilbert Guillaume (French), Jean-Denis Bredin (French), and Ahmed Sadek El-Kosheri (Egyptian).

fact that this was the only precedent accepting counter claims and whether the tribunals would follow it or not is an important question.

Some commentators go further step of assessing the environmental impact of the investment treaties themselves in order to avoid the potential inconsistency between states' obligations<sup>488</sup> and would reshape the investment provisions in compatibility with the environmental protection.<sup>489</sup> Such proposal may require using an independent environmental expertise in all committees with environmental dimensions. It is important that the decision makers should be aware of the relationships between environmental management processes of the trade agreements at the preliminary stages of negotiating these agreements in addition to the implementation stage and thus there should be some sort of balance between trade, development, and environmental dimensions.<sup>490</sup>

#### Reconciliation Committee

We would recommend creating a preliminary committee acting as a reconciliatory panel.<sup>491</sup> This committee should include representatives from members of both States, the host State and the State of investor's nationality, including legal and environmental experts to decide whether there is a taking that tantamount to an expropriation.

The major difference between this committee and the EIA process is that the latter is made before concluding the agreement between the investors and the host states as a way of predicting the impact of the investment on the environment, whereas the committee functions only after the dispute is raised between the investor and the host state in trying to evaluate the legitimacy of the state's interference with the investment utility. In addition, the EIA does not require a specific way to be made except as to be an independent one, whereas the committee is constituted by members from both states including legal and environmental experts. Furthermore, there should be a time limit for the committee to finalize its opinion and this time limit should not be long in order not to prejudice the proceedings and both parties' rights. The committee should have 30 (thirty) days to finalize its opinion.

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488. Vadi, *supra* note 445, at 203.

489. *Id.*

490. Mann, *supra* note 249, at 409.

491. The idea of this committee comes from the two tier clauses by which the parties can't resort to arbitration without fulfilling some procedural requirements. Basically, it is similar to the clauses in construction disputes that refer first to the engineer as an expert. The same applies to environmental issues but with a broader sense by which the committee does not include only environmentalists but legal, investment, and environmentalist representatives from both states.

The requirement of the committee's opinion should be used as a "fork in the road" clause which should be incorporated in the BITs to find its basis in the statutory provisions. Accordingly, any dispute involving an environmental measure should be first referred to an independent committee before resorting to arbitration to file a claim. However, the constitution of this committee should be consensual between the host state and the investor on a condition that it should include members of both States. This would facilitate the mission of the tribunal in case the dispute is referred to arbitration. The committee's opinion will constitute a mutual ground for both parties in arguing before the tribunal as they will argue only over the legitimacy and purpose of the measure only. However, the question remains whether the committee's opinion amounts to a jurisdictional award? In answering this question, a distinction should be drawn between the scope of the committee's mission and the jurisdictional issues.

The committee's opinion is just an advisory opinion. There is no binding nature of this opinion to the arbitral tribunal. It just sets up a common ground between the parties before resorting to a process that will result in a binding decision. Furthermore, the committee's opinion may induce the parties to settle the case instead of resorting to arbitration based on the preliminary opinion of the committee about the dispute. This would result in economy of costs and time. In the meantime, the committee's opinion may lead the parties to eliminate the scope of the tribunal's mandate to the disputed issues in the dispute that couldn't be settled by the committee.

A final theme is the important role of this committee. A fundamental insight is the common ground of mutual understanding of the undisputed issues between the parties, leaving the disputed ones to the tribunal. It may lead the parties to a settlement agreement without the need to resort to arbitration at all.

#### CONCLUSION

Investment arbitration has been proved from the early beginning to be distinctive from commercial arbitration due to the public interest at stake. Furthermore, when the environment is introduced as a public interest, the challenge becomes more difficult. Investment-environment disputes have their own complexity whether substantively or procedurally which harden the arbitrators' mission in resolving these disputes. This paper presents the challenges that confront these disputes and lays down some proposals that may help in finessing the tension between these conflicting interests. By offering these proposals, I hope to clarify the discussion of this issue, which until this time

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had often been suffused with ambiguity. Hopefully, the foregoing proposals will further and encourage more informed approaches going forward in these disputes.